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FOREIGN INDUSTRIAL TARGETING

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL FINANCE
AND MONETARY POLICY

OF THE

COMMITTEE ON
BANKING, HOUSING, AND
URBAN AFFAIRS
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

FOREIGN INDUSTRIAL TARGETING, ITS RESULTS AND
ITS LESSONS FOR THE UNITED STATES

CEREMONIAL COURTHOUSE, PHILADELPHIA, PA.
JULY 7, 1983

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FOREIGN INDUSTRIAL TARGETING

THURSDAY, JULY 7, 1983

U.S. SENATE, COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS, SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY,
Philadelphia, Pa.

The subcommitte met at 9:45 a.m., in the Ceremonial Courthouse, Philadelphia, Pa., Senator John Heinz (chairman of the subcommittee) presiding.

OPENING STATEMENT OF SENATOR HEINZ

Senator HEINZ. The subcommittee will come to order. This is a hearing of the Senate Committee on Banking, Housing, and Urban Affairs, Subcommittee on International Finance. The purpose of our hearing this morning is to take testimony on foreign industrial targeting, its results and its lessons for the United States.

I have a rather lengthy opening statement that I'm going to put into the record at this point as if given in full without objection.

Let me just summarize by saying that for the last two decades it is my view that the vitality of many of our basic industries for a variety of reasons has ebbed, the ranks of Americans working in those industries has dwindled steadily.

We were as a nation responsible for the production of about 60 percent of the world's gross national product at the end of World War II. Today we account for roughly one-third of that gross national product. International trade has boomed. International competitiveness has mushroomed. The circumstances of the 1940's and 1950's have given way to some very harsh realities in the 1970's and now the 1980's.

And there are some people who believe that other countries have benefited from carefully coordinated government/industry policies, that those policies—and often the example of Japan is pointed to—have been extremely successful, say, in the case of machine tools; and I believe we will have some testimony today regarding the Houdaille case from Jack Latona that government/industry cooperation indeed has been very successful.

Other people will point to all the failures of industrial policy. The Concorde comes to mind as an outstanding example of failure of industrial policy.

And the central question for this country is whether the United States should have some kind of policy aimed at responding to the trends that we are faced with internationally.

I have carefully avoided using the word in my remarks of asking whether the United States should have, quote, an industrial policy. I have done so because of the semantic difficulties associated with the word. The semantic difficulties include the notion somehow that any industrial policy must always include the picking of winners and losers. And certainly most industrial policies fall into the category of a Government picking winners and losers.

I would contend that we do make industrial policy choices in this country but we do so without any particular intellectual framework for making those choices as evidenced by the fact that the high-tech industries benefit enormously from government-sponsored research. The Pentagon spends $10 billion a year on research and development of software, which is of incalculable benefit to our high-tech industries.

The Government has created in the last 2 years a research and development tax credit of tremendous benefit principally to higher-tech industries; strangely enough not of any benefit to software industries, because it doesn't apply to products of the mind, only to products of something other than the mind. And I could list—indeed I have listed in my opening statement—a series of policies, antitrust statutes, our tax code, international trade agreements, national investments in certain infrastructure, necessities such as waterways.

I come from a city, Pittsburgh, which without the investment by the Corps of Engineers and American taxapayers would never have been a successful steelmaking center. We could not have brought the ore from the Great Lakes, nor coal from the mountains of West Virginia or as Andrew Carnegie once said he did, he took a pound of coal from West Virginia and a pound of ore and produced a pound of steel and a penny. This is a long time ago.

We in fact make human investments and have policies that are in this Senator's judgment directly aimed at having an economic impact on our industries. We have job-training programs. We have targeted jobs tax credits. We have a retraining for displaced workers program.

I would not be surprised to hear Chick Chaikin argue that within a sense—although we may not have enough of it—what the Milti Pfifer Agreement is, is a program to allow workers with marginal skills for work force attachment entry level opportunities to our work force. I happen to believe that's true, and I would guess that most Members of Congress would believe that to be true.

In sum, I think we have industrial policies in the United States. I just don't think we have given much thought to their implications. And I am going to be very interested in discussing these issues with our witnesses today.

The only other observation I would make is that I think it is unfortunate that the debate on industrial policy has gotten hot as between the fact that what we have is perfect and fine and we shouldn't really do anything else and the notion that we have to go and have an industrial policy that picks winners and losers and allocates capital because it picks winners and losers.

It is my belief that there are alternatives to that dichotomy. And to prove it—if nothing else, I happen to hope the objective is more than just to prove it—I have introduced legislation, Senate bill S. 849, the Industrial Revitalization Act, which is my properly termed adjustment bill. It marries import relief which is granted today under sections 201 through 203 of the Trade Act, an adjustment statute to an industry preparing in the same way that Chrysler was told to prepare an adjustment plan a self-help approach.

That approach, let me say for the record, avoids Government picking winners and losers. It allows industries to identify themselves. It doesn't have the Government grant capital allegation. It has the Government granting something only Government can grant. Only Government can grant import relief. And it relies on the industry, labor and management, to figure out whether they want to play that game and to what extent. If they don't play the game, if they don't petition, if they don't play the game hard enough, they don't get any relief.

It may not be the be-all and the end-all of, if you will, industrial policy. But it avoids most of the theoretical problems and pitfalls that are normally associated with the conventional misusage of the term "industrial policy."

[Prepared statement of Senator Heinz follows:]

PREPARED STATEMENT FROM NEWSLETTER OF SENATOR HEINZ

Today, the Subcommittee on International Finance and Monetary policy will take testimony on foreign industrial targeting, its results, and its lessons for the United States.

As the recent specialty steel case proves, even productive, technologically advanced industries are not immune to a concerted effort by foreign governments to promote or protect their own industries.

Throughout the 1960s, and more rapidly in the 1970s, the vitality of our basic smokestack industries has ebbed. The ranks of Americans answering the call of the factory whistle each morning and evening has dwindled steadily. The mighty engine of American manufacturing seems to be grinding more slowly. Where optimism and prosperity reigned, communities now know poverty and hopelessness.

Our national economy is entering a new age, but, for a variety of reasons, the costs of adjustment—especially for people—seems to be too high. The victims of economic change are strewn across the national landscape, but they are concentrated in the industrial heartland. In states like Pennsylvania or Michigan, you can go down to the Salvation Army and see young couples and their children. They've been unemployed, not for months, but for years. They've seen their savings disappear. Some have seen the "for sale" sign in the front yard of the home they struggled to save for. And, they're scared to death of the hospital bill should they or their children become ill.

In better times, these are hardworking, proud, taxpaying Americans. We ill serve our country if we allow fear to destroy their faith in America, and we ill serve these Americans if we allow the destruction of all they have built.

As the witnesses proceed with their testimony of the sometimes tedious detail of economic policy, I think we should all remember that our ultimate purpose is to ensure that all our citizens have the opportunity to work productively; both the young couple I referred to earlier in today's economy, and their children in the jobs and economy of tomorrow.

The winds of economic change reap pain and fear, they are driven by harsh cold economic facts. The central facts are slow growth and inadequate investment in our too low productivity basic industries.

The United States no longer possesses the edge it once had. An intensification of foreign competition has driven down our nation's share of domestic and international markets. The resurgent dollar has contributed to the decline overseas. Public policy goals, like the Clean Air and Clean Water Acts, or our National Safety and Health Laws, have diverted investment in many industries. Government tax policy makes investment in capital intensive industries, like steel, difficult. Just last Friday the President of U.S. Steel, David Roderick, testified to a

Senate committee, that the steel industry should be investing at the rate of $6 to $7 billion annually, but that the recent recession has cut the amount of investment down to $2 to $2.5 billion per year.

Inadequate investment during the last two decades, antiquated work rules, adversity between management and labor, and other causes have been pinpointed.

Some experts assert that our foreign competitors have achieved a better adjustment to economic change through well devised and implemented industrial policies—a combination of targeting resources to "sunrise" or future growth industries, and subsidization or protection for antiquated "sunset" industries. If so, we have an obligation to examine the experience of other nations to determine what set of policies and proposals can better ease economic adjustments in our own nation.

In effect, our country already has an industrial policy in the broad sense. We have enacted laws which directly and indirectly affect the productivity of our industries. Unlike a centrally planned economy, our industrial policy is the result of AD HOC intervention in the private sector. We can see impacts on economic growth from the anti-trust statutes, our tax code, government-sponsored research and development, international trade agreements, national investment in roads, railroads, waterways, and ports, our educational system, and the range of programs like unemployment compensation and retraining of displaced workers whose principal purpose is adjustment assistance. In short, our existing industrial policy has been created in response to narrow concerns, without regard to an overall strategy.

Frankly, I am skeptical of government's ability to direct industrial policy on an industry by industry basis. However, I am also uncertain that the present "scatter-gun" approach to industrial policy is in our nation's long term interest. I believe there is another road. That's why I introduced S. 849, the Industrial Revitalization Act.

My legislation is designed to link badly needed import relief—by law—to a labor-management self-help plan to modernize our basic industries.

In many ways, this is exactly what the legislation did that helped the Chrysler Corporation, only we provided loan guarantees instead of import relief. As a condition of government help, we required self-help. Chrysler stockholders had to forego dividends; its bankers put up more money; its workers made contract concessions; its management took pay cuts; and rapid product development and modernization was required. Chrysler has not only survived, it has prospered. It's time to extend that prosperity and restore vitality to our entire industrial heartland.

My legislation does not necessarily represent the best, or only solution to the programs in our basic industries. That's why we'll need to examine the policies of other nations.

I'm pleased to have such a distinguished group of witnesses to review these important matters.

Senator Heinz. Having said all that, I want to welcome our first panel, the general accounting office group, and I gather that Peggy McGregor is in charge of this organization.

Mr. Mendelowitz. I am in charge.

Senator Heinz. I have a slightly incomplete witness list. I apologize to Allan Mendelowitz. He is in charge of this group.

Allan is a former professor at Rutgers University. He is a 7-year veteran of the general accounting office. Allan.

STATEMENTS OF ALLAN I. MENDELOWITZ, ASSOCIATE DIRECTOR, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY MARGARET McGREGOR AND KATHERINE VUICICH, STAFF MEMBERS

Mr. Mendelowitz. Thank you very much, Mr. Chairman. I'm accompanied today by Margaret McGregor, as you know, who is on my left and Katherine Vuicich who is on my right. Ms. McGregor and Ms.

Vuicich are the principal staff members who did the research and the work associated with reports that we will discuss today.

With your permission I'll read an abbreviated statement and submit my complete statement for the record.

We're pleased to be with you today to discuss our reports, "Industrial Policy: Japan's Flexible Approach" and "Industrial Policy: Case Studies in the Japanese Experience." Our work focused on, one, exploring the contribution of macroeconomic policy to industrial growth, two, determining those policies which support growing industries, and, three, determining those which assist declining industries.

We examined Japan's past and present experiences with industrial policy, and we reviewed the goals and tools of Japan's industrial policy to assess how and why they have changed over the postwar period.

In addition, we discussed how macroeconomic monetary and fiscal policies have contributed to achieving the goals of industrial policy.

From World War II through the early 1970's the widely accepted consensus in Japan strongly supported Government efforts to reconstruct the Japanese economy by rebuilding the nation's basic industries and by working to catch up to the technology of the United States and Western Europe.

STRICT FOREIGN EXCHANGE CONTROLS

This was accomplished by using tools such as strict foreign exchange controls, commercial policies which gave incentives to exports and restricted imports, and controls over foreign investment and the acquisition of technology.

Monetary and fiscal policies reinforce the effectiveness of these tools in a number of ways; primarily, by maintaining a balanced budget and Government spending at a modest share of gross national product, administering a tax system which favored savings and investment, keeping interest rates low thereby both lowering the cost of investment and generating demand for loanable funds that exceeded supply, placing strict controls over domestic capital markets which effectively prevented these markets from becoming a major source of free market capital, and channeling Government-controlled resources into productive investment.

EMPHASIS ON TECHNOLOGY AND SOCIAL COMPETITION

In the early postwar years policy goals were primarily oriented toward rebuilding specific basic industries and an industrial infrastructure. By the mid 1960's Japan had largely achieved its postwar development goals and began placing growing emphasis on technology and social considerations.

Following the economic turbulence of the early 1970's Japan has focused on adjusting to slower stable growth, supporting resource conservation and environmental improvements while continuing to support the development of new technology.

With these changes in the goals of industrial policy, tools to implement these goals also have changed. Such changes are attributed to a number of factors including the financial success of Japanese firms which left them less dependent on debt financing, the relaxation of domestic regulation of financial markets which opened new avenues of financing to firms, international pressure and obligations of Japan arising from international agreements such as those under the International Monetary Fund and the General Agreement on Tariffs and Trade, increasing budget deficits and other budget priorities which place constraints on the government's ability to finance industrial development, and a rising class of structurally depressed industries.

Government influence over key industrial sectors began to weaken as a result of these factors. The emphasis of industrial policy for growing sectors today is on developing and diffusing technologies throughout the economy. Industries such as computers, robotics, and aircraft which contributed to the goals of higher value added production, greater productivity, and resource conservation benefit from government support. The support takes such form as financial assistance for joint government/industry research and development and tax incentives and special leasing programs for technology diffusion. These mechanisms for the most part work through incentive rather than control.

Rising labor costs, sluggish world demand, lower-priced products from southeast Asia—we may be a high cost producer relative to Japan, but Japan is a high cost producer relative to countries like Korea, Taiwan, Singapore, Hong Kong—increased raw material costs and foreign market import restrictions all contributed to severe economic disruptions for some Japanese industries, and in a slow growth period adjustment is increasingly difficult.

The Government has attempted to assist declining industries adjust to new circumstances by addressing short-term price and production imbalances and designing programs to address long-term structural problems. These include providing incentives to scrap excess production capacity and encouraging movement of resources into other more competitive industrial segments.

The Government also assists workers in these industries through a number of unemployment and reemployment programs. In addition, large multiproduct firms play a significant role in the adjustment process.

In conclusion, a key element of Japanese industrial policy has been the flexibility of the Government and its programs in responding to the pressures and constraints of the domestic and international economies.

However, the Government's ability to direct the course and speed of industrial growth in light of the increasing number of conflicting priorities and legislative and structural changes in industrial policy tools is now unclear.

Mr. Chairman, this concludes my summary, and we will be happy to try to answer any questions you may have.

[The complete statement follows:]

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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STATEMENT OF

ALLAN I. MENDELOWITZ
ASSOCIATE DIRECTOR, NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

BEFORE THE

SENATE COMMITTEE ON BANKING
SUBCOMMITTEE ON INTERNATIONAL ECONOMIC
AND MONETARY AFFAIRS

ON

JAPANESE INDUSTRIAL POLICY

Mr. Chairman and Members of the Subcommittee:

We are pleased to be with you today to discuss our reports, "Industrial Policy: Japan's Flexible Approach" (GAO/ID-82-32) and "Industrial Policy: Case Studies in the Japanese Experience" (GAO/ID-83-11). Our work focused on (1) exploring the contribution of macroeconomic policy to industrial growth, (2) determining those policies which support growing industries, and (3) determining those which assist declining industries.

We examined Japan's past and present experiences with industrial policy. We reviewed the changing goals and tools of

Japan's industrial policy to assess how and why they have changed over the postwar period. In addition, we discussed how macroeconomic monetary and fiscal policies have contributed to achieving the goals of industrial policy.

In Japan, macro- and microeconomic policies have worked together to achieve governmental goals. Microeconomic industrial policies helped to achieve broad economy-wide goals through their impacts on individual industries and sectors, monetary and fiscal policies reinforced the effectiveness of industrial policy tools by creating conditions that favored investment and growth.

INDUSTRIAL POLICY AFTER WORLD WAR II

The widely accepted consensus in Japan from World War II through the early 1970s strongly supported government efforts to reconstruct the Japanese economy by rebuilding the nation's basic industries and by working to catch up with the technology of the United States and Western Europe.

Japan, in the early postwar period, marshalled a large array of industrial policy tools which enabled the government to strongly influence the rate and direction of economic growth. These tools included

--strict foreign exchange controls;

--commercial policies which gave incentives to exports and restricted imports; and

--controls over foreign investment and the acquisition of technology.

For example, foreign exchange controls were used to direct resources to targeted industries and to limit foreign competition in the domestic market. The Foreign Exchange and Foreign Trade Control Law operated through a system consisting of a foreign exchange budget and import controls. The foreign exchange budget set the amount of foreign currency available for the year and allocated it among sectors of the economy. This enabled the government to effectively allocate foreign exchange and, thereby, to direct raw material imports and the acquisition of foreign technology to targeted sectors; for example, steel and chemicals. During this period, the government protected domestic industry by carefully restricting competition from imports and foreign industry through the use of import controls and controls over foreign investment in Japan.

Monetary and fiscal policies reinforced the effectiveness of these tools in a number of ways, primarily by

--maintaining a balanced budget and government spending at a modest share of gross national product;

--administering a tax system which favored savings and investment;

--keeping interest rates low, thereby both lowering the cost of investment and generating demand for loanable funds that exceeded supply;

--placing strict controls over domestic capital markets, which effectively prevented these markets from becoming a major source of free market capital; and

--channeling government-controlled resources into productive investment.

By restricting capital markets and keeping interest rates artificially low, the government was able to effectively control which industries had access to Japan's limited capital. Firms were largely dependent upon Japan's 13 major city banks for financing industrial development. The city banks, in turn, were dependent upon the Bank of Japan in order to expand their loanable funds. This interrelationship enabled monetary authorities to effectively ration credit through the city banks to targeted growth sectors. Non-targeted sectors were denied access to this cheap capital.

Fiscal authorities also allocated budgetary funds to support targeted industries. Funding came from tax revenues and the proceeds of government bond issues. Because of a commitment to sound finance principles, the only government debt incurred prior to the early 1970s was for productive investment. These bond revenues were primarily used to support the development of infrastructure. Household savings were also allocated by the government. These savings were primarily deposited in the nation's post offices, and were channeled by the Ministry of Finance to the Fiscal Investment and Loan Program (FILP). The funds were in turn allocated to local governments, government corporations and government financial institutions, such as the Japan Development Bank and Japan's Export-Import Bank, to implement government economic policy goals. Significant funds from the FILP were thus allocated to targeted industrial sectors to stimulate industrial development. The FILP account has been as large as 50 percent of Japan's national budget and thus has accounted for significant assistance to Japanese industry.

CHANGING GOALS AND TOOLS OF INDUSTRIAL POLICY

A key feature of Japanese industrial policy has been its flexibility in responding to changes in the domestic and international economies. During the early postwar period, industrial policies were geared toward achieving rapid economic growth and establishing an industrial infrastructure. As these goals were achieved, efforts were refocused on catching up with the industrialized West and developing new technology. By the mid-1970s, Japan was also giving more recognition to such concerns as the quality of life, the environment, and other social considerations. Furthermore, the rapid rise in the price of petroleum since 1973 had an especially strong impact on Japan. Roughly 75 percent of Japan's energy comes from oil imports, the highest of any major industrialized nation.

In the early postwar years, policy goals were primarily sector oriented; government and business addressed themselves to rebuilding specific industries and sectors of the economy. By the mid-1960s, Japan had largely achieved its postwar development goals and began placing growing emphasis on technology and social development issues. Following the economic turbulence of the early 1970s, Japan has focused on adjusting to stable growth, supporting resource conservation, and improving the environment, while continuing to support the development of new technology.

With changes in the goals of industrial policy, tools to implement these goals also changed. Such changes are attributed to numerous factors, including

--the financial success of Japanese firms, which left them less dependent on debt financing;

--the relaxation of domestic regulation of financial markets, which opened new avenues of financing to firms;

- --international pressure and obligations of Japan, arising from international agreements such as those under the International Monetary Fund and the General Agreement on Tariffs and Trade; and
- --increasing budget deficits and other budget priorities, which placed constraints on the government's ability to finance industrial development.

Government influence over key industrial sectors began to weaken as a result of these factors.

As trade and investment laws were amended to remove controls over foreign exchange and international trade agreements provided for reductions in tariffs, quotas, and some non-tariff barriers, the government lost an important source of its power to direct industry.

With increasing trade friction with developed nations, competition from newly industrializing countries, and economic hardships resulting from the oil crisis, the Japanese Government finds itself restraining competitive Japanese industries from foreign markets and assisting other industries to adjust to declining competitiveness. A rising class of structurally depressed industries, a number of which are energy-intensive, and the attendant employment problems have led to new legislation and government involvement in easing the adjustment process. In recent years, government deficits and high consumer and energy prices have contributed to increasing difficulties in decisionmaking and in achieving consensus. As many of the postwar tools of industrial policy were lost to legislative or structural changes, administrative guidance grew in relative significance.

Today, the Ministry of International Trade and Industry continues to influence government and industry views concerning the direction of industrial development. As a result of the constraints and legislative and structural changes mentioned above, however, the Ministry has redefined the goals of industrial policy as (1) the need for Japan to move up the technological ladder in order to increase productivity and to promote conservation of resources and social goals and (2) the need to ease the adjustment problems, particularly unemployment, of certain declining industry sectors.

CURRENT INDUSTRIAL POLICIES TOWARD EXPANDING INDUSTRIES

The emphasis of industrial policy today has shifted from industry-specific to technology-specific targets; industries are assisted in developing and diffusing technologies throughout the economy that contribute to achieving the goals of higher value added production, greater productivity, and resource conservation. Industries such as computers, robotics, and aircraft meet these criteria and benefit from government support.

Financial support for joint government-industry research and development programs is a major tool of government assistance for technology development. The government, directly or through government banks (e.g., the Japan Development Bank), provides money for various industry research and development projects defined to be within the parameters of national goals. Perhaps the most beneficial side effect of this support is that firms receiving such support are viewed as good credit risks by commercial institutions and their access to debt and equity is improved.

In addition to financial assistance, government support also comes in the form of waivers from Japan's monopoly law for approved joint activities. Under the 1971 and 1978 temporary laws promoting the electronics and machineries industries, MITI was given the authority to exempt certain activities from the antimonopoly law. During the earlier period, MITI emphasized mergers. MITI for the most part, was unable to effect these mergers and turned its attention in the later period to encouraging joint activities. Consultations between MITI, the industry and the Japan Fair Trade Commission (which performs functions similar to the Department of Justice's Antitrust Division and the U.S. Federal Trade Commission) determine the nature, participation and duration of cooperative ventures. Such ventures permit companies to work cooperatively in R&D endeavors and avoid duplicative investment on the part of an industry. Again, risk associated with sophisticated R&D is substantially reduced through this mechanism.

Another form of assistance is the use of tax deductions, credits, and special depreciation allowances to reduce the cost of development and diffusion of high technology products. Tax credits of up to 10 percent of corporate taxes are available for investment in new R&D facilities and equipment. Accelerated depreciation is allowed for facilities used to produce technologies approved by MITI. Other special depreciation allowances are available for certain machinery and equipment which embodies advanced technologies. Deductions from taxable income are permitted for income received from the export of technologies or technical services.

In addition to tax measures, the government also attempts to promote diffusion of high technology products through its creation and support of special leasing companies. These two measures assist both developers and potential users of more modern and technologically advanced products and processes. For producers, developmental risks are reduced because market development has been assisted; and for users, high-cost, sophisticated equipment becomes more affordable and product innovation more accessible.

These mechanisms work through incentive rather than control and, as a result, the nature of government influence over industrial development is different than it had been during earlier periods. Significant obstacles hamper the success of government policies in each growth industry we reviewed. Development of leading-edge computer technologies presents new risk for the government and computer companies. Problems encountered today in developing new technologies are different than those of licensing, adapting, and commercializing foreign technologies, which were successfully overcome during the last two decades. Robotics manufacturers face an as yet undefined and undeveloped market at home and abroad. They must develop products as well as demonstrate applications in order to create demand for these products. The development of new aircraft and aircraft engines has become a task too costly for one company or, in most cases, individual countries to undertake, and Japanese companies, like those in other countries, need to participate in international joint ventures.

INDUSTRIAL POLICY TOWARD DECLINING INDUSTRIES

Rising labor costs, sluggish world demand, lower priced products from Southeast Asia, increased raw materials costs, and foreign market import restrictions have all contributed to severe economic disruptions for some Japanese industries. The government has attempted to assist these declining industries adjust to new circumstances by providing incentives to scrap excess production capacity. The government also assists workers in these industries through a number of unemployment and reemployment programs.

The Japanese Government has assisted troubled industries since the 1960s. The Structurally Depressed Industries Law, passed in 1978 and extended this year, addresses some generic problems of decline. Different mechanisms are used for short- and long-term problems. For example, a rationalization cartel, which permits member companies to jointly reduce output in order to stabilize prices, is used to address short-term price and production imbalances. Plant and equipment scrapping programs are aimed at long-term structural problems. The new law emphasizes the consolidation of business operations as well as disposal of excess capacity. The thrust of the government's current financial assistance, in the form of loans and preferential financing, is directed to small- and medium-sized firms. Larger firms are expected to adjust on their own and, in the case of the shipbuilding industry, to assume some of the burden of assistance to small- and medium-sized firms.

The Japanese Government, not unlike other representative democracies, has found that political reality often constrains the formation and implementation of economically rational decisions to phase industrial sectors out of the economy. Conflicts have arisen in setting priorities and implementing stabilization programs between government and industry and between firms within an industry. Nevertheless, adjustment of declining industries has occurred, although the long-term success of this adjustment process is unclear. Some effective mechanisms do exist for employment adjustment. Private industry takes the lead in retraining and outplacement. Historically, high growth rates and a variable labor force have helped to ease adjustment. In the slower growth environment, the government has become more involved in the adjustment process. Key elements of Japan's "positive adjustment" policy include (1) recognizing that emerging industries can ease the adjustment problems of declining industries and (2) coordinating programs to assist resource shifts from declining to emerging industries.

CONCLUSION

Macro- and microeconomic policies showed a high degree of complementarity during the early post-war period, which reflected the broad consensus to reindustrialize Japan. Japanese monetary and fiscal authorities intervened directly to develop and support industrial policies during this period.

Over time, changes have occurred. A key element of Japanese industrial policy has, therefore, been the flexibility of the government and its programs in responding to the pressures and constraints of the domestic and international economies. Government credit rationing is a less effective tool for directing the private sector, because Japanese companies have become financially stronger and alternate means of financing have become available to them. Debt financing has begun to decline, although it still accounts for a large proportion of total corporate funding in Japan. The city banks' dependence on Bank of Japan funds has begun to decrease as government-set interest rates move closer to those in the free market and as financial deregulation occurs. Increased budgetary deficits, coupled with increased difficulty in financing these deficits, have placed constraints on the government's ability to finance industrial development. As mentioned earlier, industrial policy now focuses on increasing productivity and promoting resource conservation and social goals, in part through enhancing technology, as well as easing adjustment problems of certain declining industries. The government's ability to direct the course and speed of industrial growth in light of an increasing number of conflicting priorities and legislative and structural changes in industrial policy tools is unclear.

Mr. Chairman, this concludes my statement. I will be happy to answer any questions you or your Subcommittee may have.

Senator HEINZ. Mr. Mendelowitz, thank you very much.

Let me ask you this: In your statement you have described Japan's initial industrial policy, how they enacted a tax system favoring savings and investment, kept interest rates low which placed strict controls over domestic capital markets, channeled government-controlled resources into productive investments.

Why did they change? And, more importantly, how did they get themselves to change? You mentioned that there was a period of slow growth. But why if their policies had been working and they didn't work did they believe they had to change to different policies? Why did their policies stop working probably is the question I want to ask you the most.

Mr. MENDELOWITZ. The policies adopted in the early postwar period represent, I think, overt Government policies which are, unacceptable under the world trading system and international monetary agreements. Foreign exchange controls, strict limits on imports, activities like this which were used by the Japanese Government in the early postwar period to protect basic industry while it recovered from the devastation of the Second World War were tolerated by other trading countries, I believe, because Japan at that time was not a major exporter of these products. And the restoration and growth of the Japanese economy was viewed as something desirable.

Some of the tools they were using just are unacceptable. When the Japanese Government signed the IMF agreements and came under the protocols which provided for elimination of a number of foreign exchange controls, they assumed international obligations that were in conflict with their tools.

Senator HEINZ. When did they do that, what year?

Mr. MENDELOWITZ. It was 1964.

Second, I think that in the early postwar period Japanese firms were dependent on borrowed funds from banks. The banks in turn were dependent on the Bank of Japan for loans. And we had a very interesting situation in Japan where in this early period the resources of the major banks providing funding to the major corporations had resources in the form of loans in the bank of Japan; an anomaly compared to the U.S. economy.

Senator HEINZ. Let me suggest one thing.

The reason I read the four points was that I was curious as to whether you felt that each of those policies had in fact been modified by the Japanese. Now, from what I know—and I do not claim to be an expert on Japan's economy, even though I think we all try to be students of it—they still have a tax system heavily issued toward encouraging savings and discouraging consumption, and that has remained consistent.

KEEPING DOMESTIC INTEREST RATES LOW

As far as I know, they have a set of policies aimed at keeping domestic interest rates low. And they may or may not use different mechanisms than they used in the 1940's and 1950's and early 1960's, but my understanding is that they have a very explicit set of policies today that achieve perhaps by other means what they were achieving earlier. And indeed it is to their trade advantage to do because to the extent one keeps domestic interest rates low, one also weakens demands for your currency; and, therefore, you have a weak currency which is very advantageous to exporting and very discouraging to people who hope to export to your country.

My understanding is that the way they do keep their interest rates low is they maintain a series of artificial stratum within their domestic economy to allocate capital and therefore change interest rates among various sectors domestically. And, in effect, this is a means of channeling investment by new means, not by direct Government means, into a variety of industries.

Is that accurate or inaccurate?

Mr. **Mendelowitz**. Let me try to answer your question point by point, if I may.

With respect to the issue of the balanced budget, for example, Japan in the early postwar period adhered to a strict policy of a balanced budget known as the Dodge Line. This policy was modified around the middle 1960's when the Government began assuming debt financing for productive purposes. Current expenditures were supposed to be balanced by current revenues. Productive expenditures, infrastructure, things like that were viewed as suitable for debt financing.

Today, however, the general budget is in deficit and the Japanese Government has had tremendous difficulty in trying to bring that deficit under control.

As a proportion of GNP, the current Japanese national budget deficit is higher than it is in the United States.

Senator **Heinz**. Roughly what proportion of the GNP is that?

Mr. **Mendelowitz**. I would have to supply the figure for the record. I don't remember the exact number.

Senator **Heinz**. Also would you supply for the record not only your figures for them but your comparable figures for us?

[Information supplied follows:]

Japan's deficit as a percent of nominal GNP was 5.1 percent in 1981, 5.4 percent in 1982 and is estimated to be 4.7 percent in 1983. For the United States, the ratio was 2.8 percent in 1981, 3.6 percent in 1982, and is projected to be 6.2 percent in 1983. For the most recent comparable information available, net private savings in Japan as a percent of GNP was 15.1 percent in 1981 as compared with 5.7 percent in the United States.

Mr. **Mendelowitz**. Sure.

Senator **Heinz**. Not only as regards deficit as a proportion of GNP but also savings rates as a proportion of the gross national product.

Mr. **Mendelowitz**. Second, with respect to interest rates, the large Government deficits, for example, have severely limited the Government's ability to control interest rates.

Japan does not currently have a market in Government bonds the same way the United States does. The U.S. Government issues bonds. They are bought in the bond market, traded in the bond market rather freely.

In Japan the major banks are the primary purchasers of Government bonds, and they are sold to the banks at a Government set rate.

The problem, though, is that the increasing amounts that the Government is required to sell to the banks has essentially forced them to move interest rates toward a much more realistic market determined rate, because the banks are not in a position to hold onto these substantial amounts of bonds, and are now only required to hold them for 90 days, after which time they can sell them. If the interest rate paid on the bond is substantially below that available elsewhere in the market, the banks would incur a very substantial loss.

So the Government deficit itself has been a driving force in moving interest rates toward market rates and limiting the ability of the Government to use interest rates as an industrial policy tool.

I think second——

Senator HEINZ. It may have handicapped them, but has it stopped them?

Mr. MENDELOWITZ. I would say that they do not have capital markets that are as free and open and as deep as the United States obviously. There is still some effort to keep interest rates low, but I would say generally they have moved a big chunk of the way toward market-determined rates because of the force of things like this.

Essentially the force of the market has been, I think, moving capital markets to a greater freedom. Ten years ago Japan really didn't have a stock market to speak of. My understanding today is that it is the second largest in the world after the United States. So that there is some substantial movement in the area of capital markets.

TAX SYSTEM FAVORS INVESTMENT AND SAVINGS

In terms of the tax system, clearly I think the tax system still favors savings and it still favors investment. A major share of household saving is with the postal savings system, and accounts of up to something like approximately $9,000 or $10,000 yield interests which is not taxed. Our understanding is that there is a proliferation of these accounts, and so we would say, yes, the tax system certainly does favor investment and savings.

In terms of——

Senator HEINZ. What is the interest rate on a mortgage, home mortgage, and what is the minimum down payment?

Mr. MENDELOWITZ. The question that you asked about mortgages is an interesting question because it applies to all consumer credit, and that is this is a country, in the United States, where purchase of consumer durables, houses, et cetera, are generally purchased with credit in the form of long-term mortgages or long-term loans for cars, other kinds of things.

The tradition in Japan is, of course, quite different. There is considerably less credit financing in Japan.

Senator HEINZ. In addition to by custom is that also by law?

Mr. MENDELOWITZ. I don't believe it is by law as far as I know.

Senator HEINZ. There are no minimum down payment requirements for a house?

Mr. MENDELOWITZ. I have been told that down payments for housing are as high as 50 percent. When I was in Japan recently, I actually stopped to ask a few people when they bought a house what their down payments were. And it turns out that the down payment that they reported was less than 50 percent, considerably less; somewhere around the order of 25 percent. And the mortgage came from a combination of sources—part of the mortgage came from a Government mortgage agency, and part of it came from a commercial bank.

Clearly they have not had what we have had in the United States, and that is in the United States we have had a special protected financial intermediary which channeled savings into the residential construction and home purchase market.

Senator HEINZ. There is a point that I want to make for the record. There are certain profound differences either by custom or by law, some of each in both cases, I believe, that make theirs a nonconsumer society and encourage ours to be the latter.

Are there any domestic capital market controls still in existence?

Mr. MENDELOWITZ. There are still controls, and they are not moving as quickly as the United States is in the area of innovation and capital markets. And to be honest, my understanding is that they are somewhat frightened by the experience of the United States because they don't see exactly where the United States opinion is going to end up in terms of this major revolution in financial markets.

Senator HEINZ. What frightens them?

Mr. MENDELOWITZ. It is just, I think—I don't think we have a good handle on exactly what is going to happen. We had a structure in this country that separates securities markets, banks, S&L's, financial companies; and we used to have carefully differentiated types of instruments. Savings accounts, they did one thing; checking accounts another.

And essentially there's a process underway in which the artificially maintained distinctions between financial intermediaries, I believe, is disappearing as is the artificial maintenance of differences between different types of accounts and instruments, interest rates, et cetera.

Senator HEINZ. They don't have anything like that, though, yet at least. They have institutionalized a device called the trading company; and the trading company—the Mitsuki Trading Co., being the largest corporation in the world; $70 billion is their annual volume. General Motors is pretty small potatoes compared to that—is a bank, is an exporter, is a manufacturer, is an importer, is a multinational corporation, is about everything you care to name it.

Mr. MENDELOWITZ. And one of the larger exporters from the United States.

Senator HEINZ. And it is something like our third or fourth largest exporter, to perplex the people further. And in a sense even if there were a Glass-Steagall Act in Japan—which is the act in this country that prevents banks from getting into lines of commerce—the trading company that the Japanese have effectively repeals any such distinction.

I'm curious, therefore, what the Japanese are fearful of. Is it us becoming like them or is it something else?

Mr. MENDELOWITZ. No; I just think that they have some unique institutional structures, and obviously they are different. In capital markets you asked if they still had control. There's a queuing process. You can't just go to the market and sell your bonds on any day. You get in the queue, and you may have to wait a few weeks or a couple of months.

Senator HEINZ. Does the Government control the people's place in line?

Mr. MENDELOWITZ. I'm sorry? What?

Senator HEINZ. In terms of access to the capital market, does the Japanese Government control to any extent one's place in the line?

Mr. MENDELOWITZ. My understanding is no. I'm not positive. My understanding is no except for one special case, and that is pursuant to one of the side agreements reached under the most recent arrangement on officially supported credit.

An exporter from the United States who sells to a foreign customer with the assistance of a guarantee from the U.S. Export/Import Bank who wishes to borrow yen rather than dollars to pay for the U.S. export is provided immediate access to the Japanese capital markets.

Senator HEINZ. Now, let me just kind of skip ahead through your testimony. Because you kind of summarized the last half of it, it was not entirely clear to me what you thought were the most effective elements of Japanese Government policy today in terms of influencing growth in their industries.

JAPANESE SUCCESS HOLDS A CHALLENGE TO U.S.

You did read that part where they encouraged the scrapping of industries. But could you just quickly summarize what you think the Japanese are doing that really seems to work and that is successful and that does clearly hold some kind of a challenge to us.

Mr. MENDELOWITZ. I just want to preface the answer with a brief caveat, and that is our report is descriptive in nature in the sense that we have tried to report as faithfully as we could in a readable manner the development and history of Japanese industrial policies.

Senator HEINZ. I have asked you a subjective question. Can you be subjective?

Mr. MENDELOWITZ. The caveat is that the answer to your question goes somewhat beyond the report, but I will answer as best I can on a personal level.

Senator HEINZ. Very well

What we are about to receive is not necessarily the official position of the General Accounting Office.

Mr. MENDELOWITZ. OK.

I think that if you look at what the Japanese do and you look at what the United States does, there is a lot of similarity in terms of the types of interventions in the market and industrial development practiced by the Japanese and practiced by the United States.

We have a whole range of instruments, government credit, hundreds of billions of dollars of government-guaranteed credit, tax expenditures, government support for research and development; and a lot of these activities take place on an order of magnitude much larger than that which is done in Japan.

I think that the two things or three things that I would say appear to be most important about what the Japanese do are, No. 1, what they do takes place with a focus; they have a broad strategic plan or vision of where their economy should go in the future; and the instruments that are used, the government resources that are applied, are applied in concert with that particular vision. That's No. 1.

No. 2, the government support for research, development, technology, et cetera, includes both funding for research and development and support for the diffusion of the products of the research and development.

Senator HEINZ. In our terms would that mean government support to build a pilot plant?

Mr. MENDELOWITZ. It might be government support to build a pilot plant; but in the case of Japan, for example, it takes the form of government-supported leasing companies which insure the availability of technologically advanced equipment for example, to small- and medium-sized firms which don't have the capital to go out and purchase such equipment.

I would say if I were to pick——

Senator HEINZ. Is that at all like the, if you will, safe harbor leasing before it was amended into obscurity? Would safe harbor leasing as originally written into law in 1981 have accomplished the same goals as the Japanese leasing?

Mr. MENDELOWITZ. To be honest, I just don't know. I think that our recent experience with the accelerated depreciation, safe harbor leasing, a whole range of tax laws that were passed in the past couple of years is that they didn't necessarily work out the way people thought they were going to work out.

Senator HEINZ. They worked pretty well for the companies that needed the money. They didn't work out too well in terms of perceived equity for companies that supplied the moneys, because the companies that supplied the money were able to reduce their tax liability right on down to zero. And we considered that to be an unacceptable result.

So on one side of the ledger things worked fine. On the other side of the ledger they didn't work at all well.

Mr. MENDELOWITZ. I think a third area that we should not lose sight of in terms of types of things that the Japanese do that we view as successful is the coordination and mutually reinforcing roles played by macroeconomic and microeconomic policies.

There is a consistency favoring investment, development, and technology diffusion by the macroeconomic policies pursued by the Japanese Government, and the particular industry's specific policies.

And then I would say finally the last of the most significant things that they do which is worth keeping an eye on is that there is a contractual arrangement between all parties associated with the industrial policy process so that all participants contribute. I think we have an analogy in this country to the way the Chrysler loan guarantee was handled.

The major problem whenever the Government is providing assistance to the private sector is that if the assistance comes from the Government, most people are willing to get in line to take part in it. And the great risk that we run——

Senator **Heinz**. We've noticed. It's probably only a minor factor in our $85 billion deficit.

Mr. **Mendelowitz**. And I think that whenever the Government funds are appropriated—and I include in this category direct expenditures, loan guarantees where the Government assumes risk, and tax expenditures which are the use of a public resource just assuredly as a direct expenditure—the problem is insuring that what the Government does or what is accomplished with the Government's provision of resources or assistance is in fact additional to what the private sector is doing.

In the case of the Chrysler loan guarantee program, the intent of the Congress was not to bail out Chrysler's creditors. It wasn't necessarily to bail out Chrysler's employees or stockholders. A decision was made that it was in the national interest to maintain that corporate entity as an ongoing corporate entity for whatever reasons. And the loan guarantee was structured so that there were assurances that none of the assistance provided through Government loan guarantees would flow through as windfall profits or return to the constituents of the company.

Everyone involved in the Chrysler family was required to make a contribution to turn the company around as a condition for the provision of Government loan guarantees, and this notion of additionality is, I think, really a very powerful one. Everything that the Government does should be done in cooperation with and with contributions by other constituents.

ADJUSTMENT POLICY IN JAPAN

Senator **Heinz**. Let me ask you to elaborate briefly on what policies the Japanese have engaged in and have been successful in in achieving adjustment. You referred to it as kind of strapping programs aimed at long-term structural problems. What have they done? How successful is it? How do they get away with it?

Mr. **Mendelowitz**. The major industries where adjustment has been a problem are textiles, of course, shipbuilding, and aluminum among others. And I might take this opportunity to ask Ms. McGregor and Ms. Vuicich if they care to make some comments in response to your question.

Ms. **McGregor**. Adjustment policy in Japan is contained in the structurally depressed industry law which was passed in 1978 and recently replaced by a new law which went into effect July 1 of this year.

There are two basic mechanisms. I guess the first is the antirecession cartel for short-term price and production disruptions.

The second——

Senator **Heinz**. Antirecession cartel. Do you want to elaborate on that?

Ms. **McGregor**. Essentially the law provides a waiver from the antimonopoly law of Japan.

The companies in a given industry who have been designated as depressed, are permitted to form a cartel to attempt to cut back on industry output, to overcome some short-term price disruptions.

Senator **Heinz.** So the term recession applies to the industry, not to the overall economy.

Ms. **McGregor.** That's correct. The overall economy may also be in a state of recession, but that is not necessarily——

Senator **Heinz.** That does not trigger that.

Ms. **McGregor.** That's correct.

Senator **Heinz.** Thank you.

Ms. **McGregor.** The second area is a scrapping and mothballing procedure provided for in the law which is used primarily for long-term problems. This was used in the case of the textile industry for the synthetic fiber section of that industry where the Government, through negotiations with industry and labor and various Government representatives, determined jointly to scrap a certain percent of production capacity and in addition mothball another percentage of capacity for a given period of time.

Those are the two primary avenues of adjustment. In our report we looked at two industries, shipbuilding industry and the textile industry. One of the things that seems to us to be important is that there is a special section in the Japanese law which basically says that import relief tariffs, quotas, and that sort of thing is for the most part to be avoided.

Senator **Heinz.** There's a lot of evidence, however, that the reason that above board import relief is not used is that the Japanese have so many sophisticated methods of avoiding any over import relief such as performance requirements.

I understand that we have finally sold, after a long hiatus, the first American baseball bat. The question is when are we going to be allowed to sell the second, an aluminum baseball bat? You know, we had 100 percent of the Japanese aluminum baseball market, and a cheap imitation made by the Japanese got on the market. And the rubber plug at the bottom of the bat wasn't as well put in as it is on American baseball bats and it flew off and the bat flew in the crowd. Somebody got hurt.

So the Japanese said, "In the interest of national safety we believe that there has to be a national Japanese baseball bat." And because it is the national Japanese pastime, it has to be Japanese made.

But they didn't say it. They got their Japanese little league, and they got the Japanese equivalent of the American league to say that they only wanted official Japanese products to be used in their national pastime of baseball.

Clearly the Japanese have an industrial policy that isn't always what is seems to be. They keep everybody else out, and they take advantage of everybody else's open markets pretending that their markets are open.

And the question for us is: Is that a model that we should look at? Is that a model we should ignore? Should we retaliate against it? Or should we adopt some other strategy?

It is my hope that we can fashion a consensus on a strategy that will work. Some of the things Japan has done have been fairly successful. We shouldn't be a mirror image of that, but I think there are some things we can learn and certainly some things we should do something about.

ANTITRUST WAIVERS

Let me ask you one other question. You mentioned the Chrysler loan guarantee. You mentioned the antirecession cartel. It seems fascinating to me you have mentioned the two, because it seems to me that the one thing we don't have in this country are antitrust waivers for industry to get together and rationalize itself. It was a very big decision for the Carter administration 3 or 4 years ago to allow the Jones & Laughlin Steel Co. to buy Youngstown Sheet and Tube. They had to, they believe, stretch the so-called failing industry doctrine of the antitrust laws. And it was considered a very close legal cause to whether they could do that.

Is it your judgment that we should have some kind of waiver, antitrust waivers, conditioned presumably on some need, national need, to allow industries to get together, companies and industries to get together, trade facilities and rationalize our production, or should we not change our antitrust laws?

Would you care to take a crack at that?

Mr. **Mendelowitz**. That's a very difficult question.

I think that in the past two decades we have seen the internationalization of the U.S. economy, in capital markets and goods markets. And the fact that international trade is becoming such a major force in the domestic market, the traditional notions of antitrust and monopoly, I believe, do require reappraisal in light of the fact that even a single firm operating in the U.S. market in terms of a single product may not have or be able to maintain the market power that traditionally was held by a monopoly simply because of the availability of goods and services from overseas.

Senator **Heinz**. Mr. Roderick, chairman of U.S. Steel who was down in Washington, D.C., last week testifying to the Antitrust Subcommittee of the Judiciary Committee before Senator Specter and myself indicated that if the steel industry had an antitrust exemption, indeed all industry had an antitrust exemption for research and development, not for pricing, not for cartelization, just research and development, that their plans to bring steel in from Scotland to the Fairless Works in Bucks County would never have been considered by United States Steel.

Now, you have described that the Japanese sponsored joint research and development in a variety of ways.

Why shouldn't we adopt in this country a policy of joint industry-wide R&D?

Mr. **Mendelowitz**. I'm obviously not an expert on the antitrust laws, being neither a lawyer or a specialist, but I'm under the impression that in the area of basic research, where the fundamental scientific investigations take place, such joint research efforts are not necessarily a contravention of U.S. antitrust laws.

The MCC [Microelectronics Computer Corporation], which is a consortium of 11 or 12 U.S. semi-conductor companies is operating under the current U.S. antitrust laws conducting basic research.

The type of research that is done jointly in Japan for the most part is that same type of basic research. Once you move beyond basic research into applications, you are dealing with items and processes that become in essence the corporate treasures of individual corporations because the applications form the heart of any competitive advantage that any individual firm has.

And I would assume that the type of development of basic research findings into usable products are the types of things that, irrespective of the antitrust laws, corporations would continue to do on their own because the viability and profitability of the corporation depends on their ability to do just that.

Senator HEINZ. Very well, Mr. Mendelowitz. I want to thank you and your associates, Ms. McGregor and Ms. Vuicich, for being with us. Thank you very much. You have given us a good deal of food for thought.

Thank you very much.

Senator HEINZ. Our next witnesses will be Ken McLennan and Paul Tiffany.

Mr. McLennan is an eminent professor. He has worked with and for the Committee for Economic Development. He has examined the industrial policy debate extensively I'm told.

Paul Tiffany is a professor at the Wharton School of Finance. He has that distinction also mitigated by the fact he went to the Harvard Business School about 7 years later than I did.

And, gentlemen, we welcome you.

STATEMENT OF KENNETH McLENNAN, VICE PRESIDENT AND DIRECTOR OF INDUSTRIAL STUDIES, COMMITTEE FOR ECONOMIC DEVELOPMENT

Mr. McLENNAN. I would like to preface my remarks by saying that the Committee for Economic Development and its group of business and academic trustees have not quite completed our report on industrial strategy and trade yet. We are beginning to develop positions; however, my remarks today represent some of the general trends that seem to be emerging along with some of my own personal views. And we will, of course, be happy to provide a full report when it is completed in the fall.

I do have a written statement. With your permission I would like to place that in the record.

Senator HEINZ. By all means. Without objection it will be.

If Dr. Tiffany wants to abbreviate, summarize, his statement, it too will be made part of the record.

Mr. McLENNAN. The Committee for Economic Development believes that all countries have industrial policies. However, these policies in most countries are not very explicit and are not very comprehensive.

What the committee believes is that we ought to have a strategy which would coordinate these policies much more than at the present time.

One of our concerns in the current industrial strategy debate is that it appears to be a slogan or a policy for all seasons, including all political seasons; and I think this is perhaps natural within our political system.

PRODUCTIVITY PROBLEMS IN THE UNITED STATES

But our belief is that there are one or two overriding goals that industrial strategy must achieve, and that is to solve two productivity problems that we have in this country.

There is a risk that we can concentrate on the concept of an industrial policy and imply that it is going to give us some easy solution to our productivity and our competitive problems. This in our opinion is not possible, to solve anything by one simple magic solution.

Our current problems in productivity are two in nature. One is we have had a very rapid and long term decline in the productivity growth rate compared to our own historical past. This has declined from a period in the 1960's of around 3 percent to around 1 percent average per year during the 1970's; and, in fact, some years productivity grew virtually not at all.

This is significant. It is terribly important because it is the productivity growth rate that determines the standard of living of Americans. And unless that growth rate can be increased very substantially through an industrial policy or any other means, we don't believe that Americans can look forward to a very happy future.

The second productivity problem relates to our competitive problem. This productivity part of our problem is that we have had comparatively low productivity growth rates compared to our competitors, and this has occurred for a period of almost 20 years.

It always seems to us that when we are talking about industrial policy or industrial strategy issues, it is always very much easier to focus on what some other countries are doing, why they are doing it better, why they are doing things that are harming us.

The problem is that after 20 years there has been essentially a convergence of productivity levels between Japanese manufacturing and U.S. manufacturing. When you have this differential in growth rates for a 20-year period, this is simply bound to occur. And it is quite possible that if in the next 10 years we don't raise our productivity growth rates to at least what they were in the early 1960's and even perhaps higher than that, we will simply become a second-rate industrial power.

It is not simply that other countries have lower labor costs than we have. Some industries the productivity levels—which is what determines your competitiveness—are higher than in our industries, and some cases we are still ahead of them.

We believe that this is an important problem or an important part of the problem of what we do within an industrial strategy for our manufacturing base of our economy. We do not believe that we can abandon our manufacturing base. Indeed, most of the discussion of what is happening in the shift of services in our opinion is overstated.

In 1960 our manufacturing industries produced something like 23 percent of our GNP. In 1980 they produced almost exactly the same amount. What has happened is that the manufacturing employment as by share of our total employment has declined, and it declined from about 26 percent to about 22.5 percent of our total labor force.

During this period it should also be remembered that in the 1970's manufacturing employment in this country actually increased in absolute numbers. We're not in serious danger of losing our manufacturing base. Our manufacturing base is going to be important in the future. A large proportion of American workers are going to be continued to be employed there, but we have to do something about the problems in a number of our major industries.

As part of our industrial strategy CED believes that we have to look at some of the macroeconomic policies and our international trade policies which affect these problems of low productivity and the need for more explicit and the need for more competitive performance in our economy.

SERIOUS CONSUMPTION BIAS IN OUR TAX COURT

Mr. Chairman, you mentioned earlier the problem in comparison with Japan. There are a lot of things that the Japanese do differently than Americans do and perhaps do them better. But one of the things they do much better than we do is the point that you essentially raised, that is, that we have a serious consumption bias in our tax court. We also have a bias in the tax court which treats the income from different forms of capital assets, and it taxes them at a different rate.

Now, unless we are prepared to tackle this macroeconomic policy as part of our industrial strategy, then no amount of tankering at the microeconomic level is going to make very much difference.

For example, we have the ironic position of when we are trying to encourage savings by permitting people to deduct a certain amount of their current income and put it into IRA accounts, this is a very sensible idea. But at the same time I can go to the bank and actually borrow the money to put in the IRA to get the tax shelter and let the Government write off half of the cost of my borrowing it. We have this kind of inconsistency in our tax court.

Other examples include the differential tight effect of tax rates among industries. When we all supported the 1981 tax act, especially the part about more rapid capital recovery, we thought we were really moving in the right direction. And I think that lowering the cost of capital was the right direction, but we actually distorted the tax rates among industries even more than before.

When you distort—when different industries are taxed, their profits are taxed at different rates, then resources naturally flow to the most favored sector. We all live in very fancy and nice houses as most Americans do at least compared to other countries. And this bias in the tax court is probably doing more to keep our industrial development back than any other factor and even the level of current taxes.

I think that we have endorsed in another policy statement the notion of moving to a much more simplified personal income tax court and similarly trying to get rid or gradually reducing the enormous growth in so-called tax expenditures for industry and trading this off with a general reduction in the corporate tax rate.

And we believe that if we could get rid of the so-called tax expenditures in the business corporate side, we could get the rate eventually down to 25 percent from its current 46 percent.

At the present time, Mr. Chairman, some industries give virtually no tax and other industries—some of which are in the manufacturing sector—pay 40 to 42 percent tax rate.

I would like to just briefly turn to a couple of other areas where we are beginning to make recommendations.

First, of all, in the area of antitrust policies we will have some recommendations to make in this area. It is our belief that along with the statement by Allan Mendelowitz that we should encourage through our antitrust policies mergers within some of our basic industries.

Indeed, over the past 10 years—even the past several years—the concept of a changing scope of markets has begun to work its way into decisions made in the Antitrust Division of the Justice Department and other parts where antitrust policy is made.

We believe that this approach should be institutionalized law and not simply something which changes from one Attorney General to another.

Also, we would like to strongly endorse any concept which improves the operation of our international trading system. In the past too often the difficult tasks of applying have been slow and neglected, and I think our trustees would be happy to consider the bill that you have introduced in this respect.

I don't know whether we—some of the proposals go a great deal further than this, but I think we should welcome quick and rapid introduction of any unfair practices that are made by other countries.

There is some concern, I think, among myself personally at least and most economists that any protection beyond unfair competition simply is going to be a very questionable problem.

One of the things we have to remember is that the export sector in this country has been tremendously important in the growth of employment opportunities to American workers.

During the 1970's the export market, the growth and employment during the 1970's, 30 percent of that came from a relatively small export sector. What concerns us about protection beyond the notion of getting rid of unfair trading practices among our trading partners is that all that we are simply doing—at best we're simply shifting job opportunities among industries.

Indeed, it probably is a lot worse than that, because we are probably denying our exporters cost benefits from technology developed in other countries. I think, for example, that even in an area like the steel industry where there are very few jobs in export directly—because we only export perhaps about 1.6 billion tons of steel a year, and we import much more than that.

However, indirectly steel accounts for a substantial number of export jobs in this country because it develops jobs in the computer industry, in our turbine industries where we manufacture turbines to export around the world. Steel goes into these products, and it does account for a large number of export jobs.

And so this is of some concern, that we ought to really look at our own competitiveness. In this respect I would like to mention the case of Japan and one of the things we have looked at and were published in the book on this which includes something on this topic.

During the period 1965 to 1973 when Japan's industrial strategy changed, the Japanese were investing in their manufacturing sector at a rate four times as high as the rate of investment in the U.S. manufacturing sector. That accounted for a substantial advantage to the Japanese, and it was something that was based on their policies and their practices.

Finally, Mr. Chairman, I think I would like to mention that a number of our older industrial plants are out of date and either have to be rejuvenated or we have to assist the workers transfer to other sectors or other locations.

This is a very painful experience for people who have worked in the industry—in these industries for many years. However, Mr. Chairman, I do believe that our trustees will not recommend a special labor market adjustment assistance targeted to any specific industries.

UNEMPLOYMENT INSURANCE SYSTEM

Indeed, I doubt if they will recommend that we increase the funding for the Job Training and Partnership Act Title 3 very substantially. And the reason for that is that we feel this is perhaps an opportunity to look at our unemployment insurance system.

The resources involved in the funding this year under the Job Training and Partnership Act are $125 million. We have a lot of other programs that have very many resources, much bigger resources than that. A year, a good year in the business cycle, we spend perhaps $10 billion in unemployment compensation. In worst years, like this year, the expenditure will be $30 billion.

Unfortunately, the unemployment compensation system does virtually nothing for the dislocated worker who will never return to his job. In almost all States he is not even permitted to enter a training program and receive his unemployment compensation benefits. If he wants to apply for a loan to go to a community college to take a training course, he is usually excluded because of the income and asset tests in getting grants and loans under another huge program in vocational education, which has been $4 or $5 billion spent in that; and in higher education we spend in student loans and grants in the order of $9 or $10 billion.

What we believe is that these resources should be made more available to the workers who are permanently displaced and who really need the assistance. In this respect we would like to also shift some of the resources, either unemployment compensation system, toward the long term and permanently dislocated. And as part of our effort to revise and raise taxes for that program, we think this should be done.

Mr. Chairman, that's the end of my statement.

[The complete statement follows:]

STATEMENT
of
Kenneth McLennan
Vice President and Director of Industrial Studies
Committee for Economic Development
on
Revitalizing the U.S. Industrial Base:
The Role of an Industrial Strategy

The Committee for Economic Development (CED) is currently preparing a policy statement on industrial strategy and trade. Since the group of business and academic trustees (see Appendix I for list of members of the CED subcommittee) has not completed its work, I can only give you some of CED's preliminary views on revitalizing our industrial base, along with my personal judgments about how to respond to the serious problems of unemployment in many of our basic industries.

The Overall Goal of an Industrial Strategy is Higher Productivity Growth and Improved International Competitiveness

The United States currently faces two serious productivity problems. The first is the long-run decline in the U.S. rate of productivity growth and the second is our poor comparative productivity performance which has contributed in an important way to the loss of competitiveness of some U.S. industries.

As pointed out in CED's policy statement, Productivity Policy: Key to the Nation's Economic Future (1983), since 1965 the growth rate of labor productivity has declined from about 3.5 percent per annum to about 1 percent during the late seventies and came to a virtual halt at the end of the decade. Since 1981 it has staged a slight recovery, but no one is sure how much of the upturn can be considered temporary, a manifestation of the behavior of the business cycle.

The decline in productivity growth has not been confined to just a few sectors of the economy. On the contrary, it has been pervasive, involving public utilities (where growth fell from 5.5 percent in 1948-1965, to minus 2.2 percent in 1979-1981) construction, transportation, trade and manufacturing as a whole. Only communication has stood out as a persistent exception, with productivity growth actually rising from 3.2 percent per year in 1965-1973 to 4.0 percent in 1979-1981.

The pervasive decline in productivity has important implications for members of the work force, since without productivity growth they will be condemned to a stationary income level. Moreover, it will inevitably force society to forego improvements in the quality of life through a better physical environment and improvements in the education and the health of the population. CED does not believe that this pessimistic outlook is inevitable if we make productivity improvement an important goal of an industrial strategy.

The importance of international trade to the U.S. economy and the growth of employment has increased enormously over the past decade. This has brought benefits to U.S. consumers and employment opportunities for workers in the export sector have grown rapidly. But today we face the prospect of a $50 to $60 billion annual trade deficit and the jobs of many U.S. workers are likely to be threatened by import penetration of U.S. domestic markets.

The goal of improving the competitiveness of the U.S. economy is an important reason for developing a U.S. industrial strategy. Our current trade problems are directly related to a second productivity problem facing the nation -- our poor performance compared to the performance of other countries.

Between 1960 and 1980 Japan's labor productivity in manufacturing increased approximately sixfold and Germany's multiplied some two and a half times, while ours rose only by about 75 percent. Inevitably such trends mean that productivity levels in at least some other countries are converging with ours. Figure 1 attempts to compare the convergence of U.S. and Japanese productivity levels for manufacturing. These estimates clearly show that on average Japanese manufacturing is just as productive as U.S. and Japanese productivity levels for manufacturing. In some industries U.S. productivity may still be the leader, but in others we have already been outstripped by our competitors. In the steel industry, for example, Japanese output per person hour was some 5 to 20 percent behind ours in 1972, but now exceeds ours by 20 to 50 percent.[1]

The Policy Response Should be a More Explicit, but Non-Targeted Industrial Strategy

Achieving the goals of an industrial policy does not imply more government intervention through a new expenditure, loan or tax incentive program. If the goal of an industrial strategy is to facilitate the adjustment to structural change we must understand how current government policies affect the response to the changing structure of the economy.

In the United States, the government has traditionally intervened in the private sector in an *ad hoc* manner, creating biases in resource allocation

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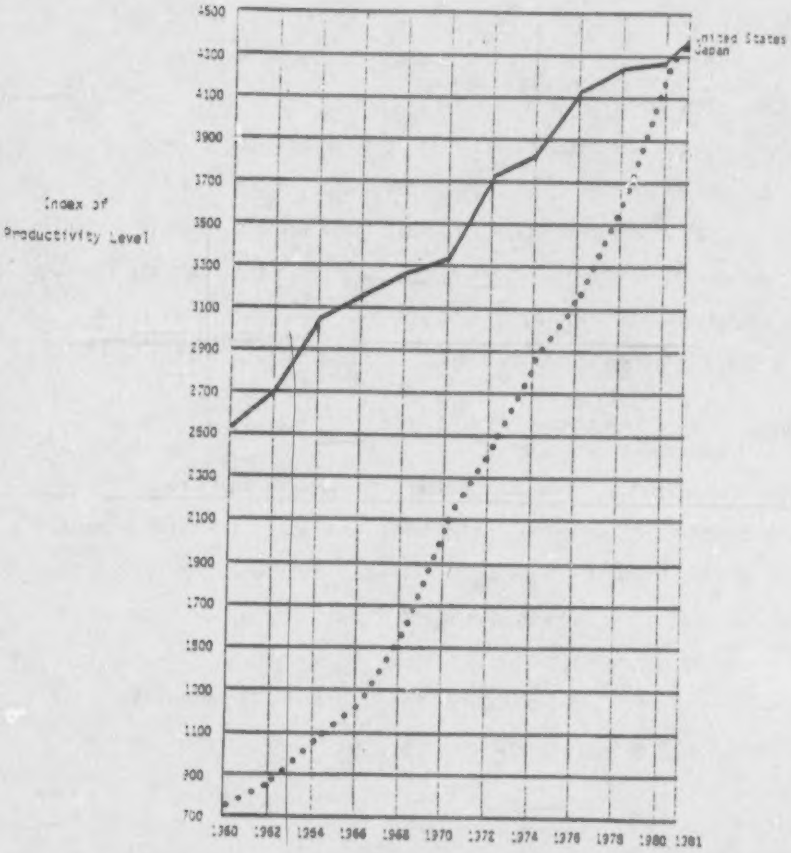
1. Unpublished data, U.S. Department of Labor, Bureau of Labor Statistics.

Figure 1

Convergence of U.S. and Japanese Manufacturing
Productivity Levels*



*The benchmark year for the comparative levels is 1977. The relative productivity levels for 1977 are based on the Japan Productivity Center's industry comparison of most manufacturing industries in each country for the 1970s. These results, including productivity growth rates, were similar to available data from the U.S. Bureau of Labor Statistics. To determine the estimates for the period 1960-1981, the U.S. government's growth rate statistics were applied to the Japan Productivity Center's 1977 productivity level estimates.

SOURCE: Committee for Economic Development, 1983.

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and in some cases actually inhibiting the adjustment process. The response should not, as some advocate, be more government intervention targeted to assist specific industries, firms or groups of workers. The goal may be less intervention or at least making the intervention more neutral among industries and geographic regions. Indeed, the underlying theme of the proposed CED policy statement will be greater reliance on the market system as a mechanism for adjustment to economic change.

The Magnitude of the Problem Facing Manufacturing Industries in the Seventies

The notion that future changes in demand, technology and comparative advantage in trade, will be so dramatic that within a decade a significant portion of manufacturing jobs will be lost to foreign competition is grossly misleading. While other sectors of our economy are important to our standard of living, manufacturing, including manufacturing exports, is a major source of employment. For example, in 1980 about 65 percent of the value of U.S. exports was in the form of manufactured goods. The future competitiveness of the entire manufacturing sector is essential to the standard of living of the labor force and the ability of the nation to meet the goals of social policies.

Structural change will continue to change the relative importance of sectors of the U.S. economy but such changes are always gradual. In 1980, for example, manufacturing output accounted for 23.7 percent of our GNP; this was almost the same as in 1960 when it was 23.3 percent.

Structural change appears more rapid when it is measured by changes in the distribution of employment among industries. The share of manufacturing

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employment in the labor force declined from 26.4 percent in 1970 to about 22.2 percent in 1980.[2] In most labor markets workers made this transition with little difficulty. There was little worker dislocation since in a highly mobile labor force workers move voluntarily to other jobs and over a decade perhaps 10 percent of the industry's work force retire voluntarily. The transtion during the seventies was also easier because the absolute number of jobs in manufacturing increased.

For a small proportion of the work force dislocation was difficult because permanent layoffs were not evenly distributed among industries and local labor markets. Some workers were laid off because their job has been eliminated and there is little or no growth in these jobs in the economy. Estimates of the magnitude of this problem in the late seventies suggest that in any year significantly less than 1 percent of the labor force were affected by this type of permanent structural change. However, the adverse affects of the change resulted in permanent income losses for many of these workers and their communities suffered considerable economic and social distress.

The Pace of Future Structural Change

There is no question that the proportion of the labor force in manufacturing will continue to decline during the eighties. Estimates by the U.S. Bureau of Labor Statistics suggest that the proportion of workers in manufacturing will decline to about 19.5 percent. However, *it is estimated that manufacturing employment will continue to grow by about 1.7 percent over the decade*.

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[2] See testimony of Kenneth McLennan on The Future Role of Manufacturing and Service-Type Industries in the Economy: Implications for Productivity Policy before the Subcommittee on Employment and Productivity, United States Senate (97th Congress, 2nd session, May 1982). For further information, see also U.S. Senate, Committee on Labor and Human Resources, Productivity in the American Economy: Report and Findings (Washington, D.C.: U.S. Government Printing Office, 1982).

These employment projections may prove to be somewhat optimistic. The introduction of new technology, such as microprocessors and so-called robotics into the production process may be more rapid than currently predicted. Similarly, the commercial application of genetic engineering may prove feasible in more industries and at a more rapid pace than now thought possible. Research on the application of these innovations suggests, however, that while these innovations will significantly change production processes in a number of industries, it will take many years before they are widely diffused throughout industry. As innovations are introduced throughout the eighties the structural shifts *within* manufacturing are likely to be much greater than changes *between* manufacturing and other sectors of the economy.

The Concentration of Structural Problems within the Manufacturing Sector

The problem facing any industrial strategy is what to do about few industries within manufacturing in which much of the structural change and dislocation are concentrated.

During 1981 the sales of *all* auto manufacturers both here and abroad suffered and by November 1982 almost 252,000 U.S. auto workers in direct manufacturing were on indefinite layoff. The overall unemployment rate for the industry was 23 percent. This unemployment rate is significantly higher than the rate for manufacturing as a whole, which was 14.8 percent in December 1982.

Much of the decline in demand in the industry has little to do with structural change; the decline in total demand for autos during the recession and the interest rate cost of automobile financing are cyclical causes of depressed economic conditions. Gasoline prices could explain a structural shift in demand but these prices have hardly risen in the past two years. Fuel efficiency and the rising cost of automobiles also affect demand. There will be structural problems only if the cost of production continues to rise and it proves impossible for U.S. automakers to make further improvements in fuel efficiency. Increased imports is only one potential source of permanent structural change, but this factor is closely related to fuel efficiency, U.S. costs of production and changes in the exchange rate.

Structural change could also occur if there were increased capital intensiveness in the production process. The U.S. industry will have to make substantial investments in new plant and equipment if it is to prevent further import penetration. Such investments will, however, be phased in gradually and much of the resource adjustments will occur through attrition.

The nature and sources of the problem facing the U.S. steel industry are different from the auto industry, though the problem in both industries has common elements -- the persistent threat of impact penetration (even in the face of a recession), and rapidly-rising unit costs of production since the late seventies.

The demand for steel is strongly influenced by the demand for automobiles. In December 1982 the unemployment rate for workers in primary metals was 28.6 percent, twice the rate for manufacturing. Steel workers in basic steel and iron foundries make up a little more than half the employment in primary metals. Given the differences in the demand for primary metal output and basic steel, the unemployment rate among steel workers was undoubtedly higher than 28.6 percent.

Industrial Strategy Policies to Revitalize the U.S. Industrial Base

There is no simple or painless solution to the problems in some of our basic industries. Indeed, it is always much easier to blame unfair trade practices, targeted industrial policies by foreign governments and manipulation of exchange rates than it is to face some of the difficult decisions which will have to be taken by policymakers, business managers and labor leaders if our basic industries are going to retain or restore their competitive position in domestic and international markets.

- Noninflationary macroeconomic policies and strengthening existing international trade agreements constitute the basis for other policies within an industrial strategy.

Unfair trade practices, including dumping and exchange rate manipulation by foreign governments do exist and the government should counter such actions and place maximum pressure on our trading partners to open up their markets. Such actions are an important component of an industrial strategy.

If the strength of the U.S. dollar is reducing the competitive position of U.S. goods and services we must take action to reduce interest rates through fiscal policies which reduce the size of the federal budget deficit. Similarly, if a major part of our loss of competitiveness is due to outdated manufacturing plants tax policies must be adopted which encourage saving and investment, and reduce the current consumption bias in the tax code.

- Labor and management must reduce labor costs and link future compensation increases to productivity performance.

Labor and management must also face up to their responsibilities if rising unit labor costs are a significant part of the problem. The combination of rising labor costs, low productivity growth and declining demand for the products of our basic industries, as well as the final goods and services which use the output of our basic industries, is a sure prescription for more unemployment and accelerating structural change.

There are encouraging examples of actions taken by management to improve their firm's competitive position and in some cases labor and management are jointly attempting to improve their unit costs of production.[3] But there is also increasing pressure for protection from imports well beyond anything that could be justified by the actual existence of unfair competition.

- Temporary protection may help industries targeted for assistance but could harm workers in other industries.

There may be some cases when temporary protection or assistance to industries, or even firms, can be justified but in some cases the protection may simply delay actions to improve competitiveness. Senator Heinz has developed an imaginative legislative approach to avoid this problem should temporary protection be justified on economic or social grounds.

There is an additional problem with protection against import penetration. At best protection only redistributes the unemployment among industries. Over a period of several years protection does not generate any net growth in jobs even though in the short run jobs in the protected industries are obviously saved. For example, if we protect the steel industry from "fair" competition we raise the cost of production in other industries, many of which employ U.S. workers producing goods and services for both domestic and international markets. This raises the cost, and possibly prices, for steel-related products causing a decline in demand for workers in other industries. The production of steel itself generates directly only a relatively small proportion of the estimated 6 million jobs in export-related employment since we only export some 1.8 million tons of steel per annum compared to 16.7 million tons of imports. However, it is estimated because of the importance of steel in metal stamping, construction, mining and oil field machinery, engines and turbines, computer products, etc., the steel industry is indirectly related to some 123,000 jobs in the export sector, which is more than the jobs generated by the exports of computers in which the U.S. has a dominant lead in world markets.[4]

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[3] See Productivity Policy: Key to the Nation's Economic Future (New York: CED, 1983), Chapter 6.

Apart from raising the cost of production of goods for the U.S. domestic market and the export market, protection of the U.S. steel industry could lead to retaliation which would have a direct employment effect on many U.S. industries.

Even if foreign countries do not retaliate they will have less dollar earnings to buy our products. This will raise the value of the dollar in terms of other currencies and make it more difficult for our exporters to sell their output.

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[4] See Lester A. Davis, "Domestic Employment Generated by U.S. Exports," Staff report, International Trade Administration (Washington, D.C.: U.S. Department of Commerce, April 1983).

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- The growth of trade, under effectively implemented international trade agreements is essential to future employment growth

The export sector has become a significant source of employment growth. It is estimated that the growth of manufactured exports accounted for some 30 percent of the total employment growth between 1977 and 1980. Any actions which constrain this trend will eventually result in a net loss of U.S. jobs as the total value of goods and services in the U.S. economy will be less than it would have been without any protection. The effect of using protection to "create" jobs in our basic industries will result in failure to expand output in other industries -- usually high-technology industries who are producing products for expanding markets.[5]

The importance of industrial policies in explaining the competitive challenge from other countries has little to do with any attempt to target their industrial policies. Even in Japan which has had some targeting successes, by far the most important reason for their highly competitive economic position has come from their savings rates of three to four times the rates in the U.S. and because during the period 1965-1973 their gross rate of investment in manufacturing plant and equipment was four times as great at the U.S. rate of investment. In contrast, we have failed to increase our net stock of manufacturing plant since 1973.

Any U.S. industrial strategy must be clearly linked to monetary and fiscal policies which will significantly reform the tax code to stimulate investment and control the growth of government expenditures (see Appendix II for description of the CED concept of an industrial strategy). It is equally important for the U.S. government to negotiate improvements in current trade laws with its major trading partners. We should jointly seek ways to reduce any unfair trade practices and avoid the spread of protectionism in all countries.

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[5] For the preliminary results of an empirical study of the industry gainers and losers from protecting our basic industries see Almon, Clapper et.al., "The Inforum Interindustry Macro Model with an Application to the Effects of Protection," (Maryland: Department of Economics, University of Maryland, 1983, mimeo).

- Effective public and private domestic policies are crucial components of a U.S. industrial strategy which facilitates the adjustment of resources to their most productive use.

As the economy emerges from the recession most unemployed workers from our basic industries will return to their jobs since most of our manufacturing plants are as productive as plants in other countries. But workers employed in our least competitive operations may never return to their former jobs. The following possible responses are open to management and labor:

- Through free collective bargaining management and labor can negotiate labor compensation structures which reflect the productivity level of each individual plant.

This would represent a reversal of the trend toward pattern bargaining and multi-plant wide-bargaining. Such a response should, of course, be up to the parties of collective agreements, but as the scope of markets has expanded it may no longer be possible for more efficient plants to subsidize the less efficient ones. Plant level bargaining provides workers and management with an important incentive to raise productivity at individual plants.

- Management and labor can work together to increase flexibility in job assignments, and at the plant level involve unions and workers, in a meaningful way, in joint efforts to improve productivity.

- Management and labor can negotiate wage structure which give greater weight to performance so that throughout the entire work force there is an incentive to innovate.

Since a portion of the productive facilities in some of our basic industries are out of date and noncompetitive, government has a responsibility to examine how its current policies may be unnecessarily contributing to industry's problems. CED is likely to recommend the following type of policy changes which could affect basic industries.

- If there are restrictions in our antitrust policies which restrict mergers among companies in the same industry, CED believes they should be removed provided there will still be sufficient competition in markets.

For example, in parts of the steel industry, the high cost of constructing new facilities may make it essential for major companies in the industry to consider mergers as one way to modernize plants and gradually phase out the least productive capacity. Since the market for steel is now worldwide, modification of our antitrust act may not be inconsistent with the competitive goals of these policies.

- If the cost of meeting regulatory environmental goals may fall disproportionately on our basic industry the government could permit industry flexibility in meeting these goals, rather than designating the specific technology to be used.
- The government should review the effect of the current tax code on our basic industries. For example, for industries which have had low profitability over the past several years it may be impossible for firms in these industries to take advantage of legitimate deductions generally available under the corporate tax code.

As part of the effort to revitalize our basic industries some workers will be dislocated and have to move to other jobs. The government has a responsibility to assist them make this adjustment. The following are some of the approaches CED is likely to recommend:

Funding for Title III of the Job Partnership Training Act could be gradually increased to help train experienced workers who have been permanently dislocated. However, decisions on the type of training and the delivery of the training services should be local decisions since local labor, business and public institutions are in the best position to assist displaced workers.

In terms of resources available to assist dislocated workers, CED believes that the $15 to $20 billion spent annually through our federal-state Unemployment Insurance system does virtually nothing to help the displaced worker readjust. CED is considering recommending changes in the so-called "waiting period" and in the "experience-rating" system in an effort to reduce the instability in employment and encourage management to plan for more efficient utilization of their work force.

CED recommends shifting more of the UI resources to those who need it most -- the long-term dislocated workers. We are also likely to recommend reforms which will provide more job search assistance to unemployed workers and permit them to receive retraining and at the same time receive UI benefits, something that is not now possible under many state UI systems. We are also supporting the concept of making it easier for dislocated workers to receive assistance through our large vocational education and student grant and loan programs. A similar concept has already been proposed by your colleague, Senator Dan Quayle.

Mr. Chairman, in the area of worker adjustment policy CED strongly believes that we do not need a large new program for a narrowly-defined group of workers in specific industries. Experience both here and abroad has shown that such a targeted approach to industrial strategy is counterproductive. In fact, such an approach has simply retarded the adjustment process and done little to help the dislocated workers.

CED believes that existing labor market policies must give a higher priority to the dislocated workers and thereby reducing the time it takes them to find new jobs in a period of economic change. If we can design policies to achieve this goal we will not only help the displaced workers but we will also ensure that the current and future generation of workers receive the benefits of economic change.

Appendix I
May 1983

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COMMITTEE FOR ECONOMIC DEVELOPMENT
May 1983

APPENDIX
K. McLennan

CED's View of an Industrial Strategy

All developed economies have industrial policies. In some countries the goals of these policies are relatively explicit, and a coordinated industrial strategy is developed as part of long-term government planning, designating which industries and regions will be assisted over the next several years. These plans are seldom binding; therefore the emergence of a set of explicit goals from government planning does not necessarily mean that government policies will actually be enacted to provide preferential treatment to these specific industries and regions. Even if such policies are implemented, experience from abroad demonstrates that they are frequently unsuccessful in achieving the goals set out in the planning exercise.

In most countries, however, industrial policies are not comprehensive and consist of a combination of separate economic development policies, investment incentives and protection of specific industries from foreign competition. The absence of a stated policy goal for specific industries or regions should not imply that the government has no industrial policy. An industrial policy may be implicit within a broad range of microeconomic policies toward specific sectors of the economy. These policies may be uncoordinated within the policymaking processes of government, but that does not mean that they are either more or less effective than a more explicit industrial policy.

The United States has traditionally relied on an implicit industrial strategy. However, the intensification of international competition, along with slow economic growth and poor productivity performance, has led to proposals for a more cohesive public policy strategy toward all sectors of the U.S. economy.

- Goals of an Industrial Strategy

  Most proponents of an industrial strategy agree that control of inflation and much more rapid productivity growth rates are essential ingredients for improved U.S. international competitiveness. The CED approach also stresses the importance of facilitating the adjustment of resources in response to continuous structural changes in the economy, brought about by the emergence of global markets, changing trade patterns and technological innovation. In contrast to other proposals for industrial policies, CED advocates that micro-level government policies affecting resource allocations be as neutral as possible, with the market system determining those sectors which will expand and those which will contract.

- Components of an Industrial Strategy

  The major components of CED's approach to industrial strategy are as follows:

  -- Economic environment:

Continued...

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- Specific macroeconomic policies can affect the distribution of resources within a market economy and are interrelated with micro-level policies within an industrial strategy.
    + Control of inflation is essential for reducing the disincentive to save and to invest in R&D and new plant and equipment.
    + Tax and expenditure policies can distort the allocation of resources among industries and sectors of the economy.
    + The balance between monetary and fiscal policies can indirectly affect the competitiveness of U.S. goods and services in international markets.
- Micro-level government policies to facilitate adjustment to continuous structural change through the market system.
    + Policies which impede the operation of markets (e.g., inefficient regulations) represent government "failure" and should be removed as part of an industrial strategy.
    + When private markets "fail" or produce socially undesirable results, government intervention can be justified, but only to the extent that government intervention does not produce a result worse than the initial market failure.
- Policies to facilitate the adjustment to change in international markets and maintaining the benefits of trade.
    + Resources should be encouraged to adjust to changes in international markets so that society will benefit fully from increased trade. But at the same time, U.S. policy must be prepared to react to actions by other countries who target specific industries for export growth by subsidizing these industries and protecting them from international competition.

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Senator Heinz. Thank you very much. I'm going to have a few questions, probably more than a few, but a few questions for you.

Let me turn, though, at this point to Paul Tiffany.

Professor.

STATEMENT OF DR. PAUL A. TIFFANY, ASSISTANT PROFESSOR OF MANAGEMENT, THE WHARTON SCHOOL, UNIVERSITY OF PENNSYLVANIA

Mr. Tiffany. Senator, Mr. Chairman, let me begin by saying that I believe the Senate bill 849 which you have introduced is a fine discussion paper, as indeed you propose it to be. You, I believe, in your testimony of the introduction of that bill wanted to open the discussion to a broader audience; and I think that that bill will do that.

I have some of the same fears that you do, as you mentioned at the outset of your talk this morning, about the notion of an industrial policy, some of the semantical fears of picking winners and picking losers, which tends to become a self-fulfilling prophecy and has some downside affects there that should be avoided.

Before getting into some specifics on that, however, I think it would be interesting as well as informative to talk somewhat about the notion of an industrial policy, because S. 849 is in fact a bill designed to get out that very problem. And, indeed, much of the material we are talking about today is in one way or the other directly related to the notion of an industrial policy.

NO INDUSTRIAL POLICY IN AMERICA

Probably a good starting point is: Why is there no industrial policy in America? You seem to feel earlier that we have one, and we do to a very limited degree; but certainly not of the robust variety that most people tend to associate with industrial policy as it is practiced in Japan, in France, in Germany, in certain other countries.

Why do we not have one here? I think one of the primary reasons is that an industrial policy tends to be a luxury that nations that are not the leading economic nation in the world can indulge themselves in.

A nation does not have to be a second-tier economy but, nevertheless, the responsibilities that go along with being the dominant economic power, such as the United States is, almost mitigates against the very notion of an industrial policy.

From 1947 on this country decided to exercise the political and economic power that it had long enjoyed since the late 19th Century, and it set about constructing a system of laws and practices that helped to resuscitate the entire world economy. The basic rationale that many of the other nations practiced so-called industrial policy was an infant industry argument. Much of their key industry have been demolished or severely hampered by the effects of the war. These nations tried to put together programs that would help them recover.

Another reason for the lack of an industrial policy in this country aside from the fact that it simply did not comport well with the economic position that we took after 1945 is that the term policy itself, the term industrial policy is perhaps a misnomer because industrial policy is really a process. It is the process founded in a close degree of cooperation and of administrative streamlining between the various economic actors within a society; primarily business, government, and labor.

That sort of cooperation has never—has never been the hallmark of American business, Government, labor relations. Instead, because of a long history compounded by various things, an adversarial posture has been much more characteristic of the way we go about doing our business in this country.

There are many benefits to this. It certainly ties in well with the basic democratic rights that we have in this country, all sides should have a view, there should not be any centralization of power in any one agency, be it the Government or anything else.

As such, however, we have developed a culture in this country. We have developed a method of going about establishing economic policy that mitigates against the sort of control, if I may use the word, the sort of coordination that resides in what is known as industrial policy.

Moreover, there is an unfortunate lack of respect for the ability of the Government to conduct such policies. Again, these are founded in deep-seated historical factors. They have been embedded within the culture of the country, and the sort of environment that is necessary to carry out and implement an industrial policy simply does not work in this country.

As such I would say then that an industrial policy is primarily an administrative process that's embedded in the economic and political culture of a nation and that to simply attempt to create or impose such a policy today in the United States is almost doomed to failure by the very nature of the political system that we have.

What we end up with when we have industrial policy is ad hoc Band-Aid-type programs that are the result of pressures brought about by specific instances, and we have nothing in terms of the more coordinated, the more systematic, indeed more elegant as it were industrial policies that we find abroad.

DISTRIBUTION OF POWER BETWEEN BUSINESS AND GOVERNMENT

If we look at Japan, for instance, one of the reasons we don't have these type of policies is the distribution of power between business and government. It's interesting that in those areas where this Nation does have somewhat of an industrial policy such as in the defense sector or, if we can call it industrial policy, the policies in our agricultural sector, it is interesting to know that the calling forth of these policies were really done by a government.

It was the Government that called the defense sector into being. And it was actually some Federal Government in the thirties that did much to create the very powerful agricultural sector that we have today.

But if we look at the other major sectors of the economy, certainly those that have problems today such as auto, steel, et cetera, the business side was in power, so to speak, long before the Government began to get involved in economic management to a great degree, which did not occur in this country until the thirties. And as such these business leaders have never been able, in many cases have not been willing to work closely with Government to establish the types of programs that would be subsumed under an industrial policy.

When you compare this to the nations that we look to today that have industrial policies such as Japan, we see a totally different situation. The modern Japan really began in 1868 with the Magi revolution. Government there decided that Japan would be thrust into the modern age. They called forth the major industries. Government did. They set up the system whereby Japan would become an international economic factor.

As such there was never any of the deep-seated historical antagonism or adversarialism between those various economic factors. The same has occurred in France, in Germany, and in other countries.

In this country, however, that simply has not been the way things have worked; and it has been much to our detriment today. The industry that I am most familiar, the steel industry, is perhaps one of the leading examples of this. It is interesting that after World War II the American steel industry was very much aware of what was going on in the development of foreign steel industries.

And, indeed, the American steel industry repeatedly tried to call attention to the Government to say the aid programs that the Federal Government was putting into place to resuscitate the steel industries of Europe and Japan, they were someday going to create a situation whereby the United States industry would lose its competitiveness. They wanted to work out a program that would try to get around that.

And in 1953, in fact, the American Iron & Steel Institute submitted a detailed proposal to the Randell Commission, which in 1953, when Eisenhower first came into office, he undertook a major reevaluation of foreign economic policy. Randell—who at the time was president of Inland Steel—he put in as Chairman of this Commission; and the mandate was to review American foreign economic policy.

Well, the AISI submitted a statement saying we should set up a department called the Foreign Trade Department which looked very much like what Senator Roth is calling DT today and what works under MITI in Japan.

And the institute said we need some sort of coordinated program here in order to insure that the interests of American industry will be looked over as closely as the interests of foreign industry.

Unfortunately, that proposal went nowhere. It fell into the mishmash as it were of policymaking in this country. A variety of interests got involved, and it went nowhere.

What we end up with in industrial policy is something similar to the Solomon report of December 1977, a report founded in the pressure of having to do something immediately because of the down cycle in steel in 1977, the wiping out of tens of thousands of jobs in the Mahoning Valley, the creation of the steel caucus, and much political pressure being brought under the administration.

Solomon put together, I thought, an incipient industrial policy in his entire report. What came out of it unfortunately was only a one-prong policy, TPM, which did nothing, did absolutely nothing to resolve the long-term problems of the industry. Solomon himself said to me that he believed that TPM was only one minor part of it. It would provide some of the financial wherewithal to put into place the means of reviving technology, of perhaps providing some worker adjustment assistance, things like this.

What happened, though, is that the industry took the money and ran, so to speak. There was nothing in this particular proposal that would have mandated that the larger terms of the Solomon report be implemented; and, indeed, they never were.

That, I believe, is far more indicative of the types of industrial policies that we have in this country. What to do about it. Does this mean that given the basis of political culture in this country, we should walk away from these problems? Obviously not.

I think S. 849 is an interesting beginning insofar as it attempts to put some—it puts some means in it to insure that assistance to a specific industry will indeed result in some of the longer-term rationalization effects that are necessary to help productivity, to help reinvestment, help those types of activities.

I have some specific reservations about S. 849. I'm not quite sure why the International Trade Commission is the appropriate body to carry that out.

Senator HEINZ. As Hillary and Jensen said when asked why they climbed Mt. Everest, because it's there.

Mr. TIFFANY. Academics, unfortunately, try to build models. They look at things in a much too nice refined sort of way and I think myself would like to see something like the DT proposal enacted in this country. I'm not quite sure that the specific political skirmishing that surrounds Roth's bill is exactly what we want, but something of that sort. Because if industrial policy is to have any sort of impact, I think it has to be far more coordinated, far more comprehensive, far more systematic than what the ITC can bring to bear on this particular subject.

Senator HEINZ. By the way, the ITC commissioners have individually looked at S. 849 as individuals and not as the commission, and they are just enthusiastic. Even those who are retiring from the commission are enthusiastic about it.

I cite them specifically because the others might be accused of having an ax to grind.

Mr. TIFFANY. I tend to think there might be an ax there regardless, because one of the problems I see with the ITC is the fact that you are dealing with political appointees who are going to be subject to pressures from the White House as well as the other members of the adjustment group that you proposed. A representative from commerce and labor, again, will be political appointees.

JAPANESE INDUSTRIAL POLICY ABOVE SKIRMISHING OF POLITICS

The reason that industry policy worked in Japan and other countries is that to a large degree it has been elevated above the day-to-day skirmishing of politics. It has been put into place. And, again, this is a product of a long-term historical and cultural development. It is a product of that.

Being above politics, as it were, gives those bodies abroad luxuries and opportunities to operate that simply do not exist here. That indeed is a basic reservation I have about industrial policy, do we have the political apparatus to put into place a long-term agency like that, a permanent agency that can attend to the long-term economic needs of the country.

I like to believe that, yes, we can make a start on it, and I think S. 849 is an interesting way to begin that discussion. But I envelop all of my thoughts in that with this kind of gloomy cloud of suspicion, that it simply has not worked in the past; and I'm not so sure if it will work in the future.

THE UNITED STATES HAS ENJOYED AN ARTIFICIAL POSITION IN WORLD ECONOMY

One last word is that, as Ken said, the rest of the world has caught up. Much of the current debate about industrial policy is the result of this historical fact that the United States to a large degree enjoyed an artificial position in the world economy from 1945 until 1970. It took the rest of the industrialized world a number of years to get back to where they had been prior to the destruction.

As such we are seeing not so much a terrible downslide in the American economy as we are seeing more of a return to balance, a return to equilibrium of the way the industrial world works.

I think that this does not deter from the fact that we have to do something about adjustment assistance. I think the CED proposal is an interesting one, that let's not really do anything for adjustment assistance because the squeaky wheel will force us to look at unemployment insurance, things like that.

Meanwhile, however, you have tens of thousands of people whose lives through the accumulation of assets over dozens and dozens of years are being wiped out. In the depression Hoover said, "Well, let's not do anything because in the long run everything will work out."

And Kane's remark was, "In the long run we are all dead."

And, unfortunately, people have lives to live now; and they want to do something about it, and they demand that their Government take some steps.

My own belief is that some of the targeting steps in terms of providing workers adjustment assistance are entirely, entirely proper and entirely legitimate and entirely justified. Something is going to have to be done in that respect. I would only hope that it does not become a political grab bag, it does not become a shield to maintain current industry status in the face of economic change, which is unfortunately what happened with the Solomon report. It was not used in the manner that Solomon hoped that it should be.

Thank you Mr. Chairman. That completes my statement.

Senator HEINZ. Thank you very much, Dr. Tiffany.

[The complete prepared statement follows:]

A STATEMENT BY DR. PAUL A. TIFFANY

BEFORE THE INTERNATIONAL FINANCIAL AND MONETARY POLICY SUBCOMMITTEE OF THE U.S. SENATE BANKING COMMITTEE, SUBMITTED ON JULY 7, 1983 IN PHILADELPHIA, PENNSYLVANIA.

Introduction

My name is Paul Tiffany and I am a professor in the Department of Management at the Wharton School, University of Pennsylvania. My area of specialization is corporate strategy and comparative business-government relations, with a special emphasis on the American steel industry. I am pleased to have this opportunity to offer comment before your subcommittee in reference to s. 849, a bill sponsored by Senator John Heinz that has been titled the "Industrial Revitalization Act of 1983."

There can be little doubt that industrial revitalization is one of the compelling public questions facing America in the 1980s. One has only to review the decaying industrial structure and related statistics of unemployment in the State where we currently meet [Pennsylvania] to realize that the issue is not some vague abstraction of concern only to public policy specialists, but rather that it has an import for the citizens of the nation at large. Quite correctly, the question of "industrial policy" (as the revitalization issue has generally been termed) is of late receiving considerable attention in both public and private forums as well as the general press. Indeed, the issue also appears to have spawned one of the most vibrant growth industries of recent memory; if the auto or steel producers could realize but a fraction of the business seemingly enjoyed by "industrial policy" book publishers, then perhaps there would be no need for further action!

As we well know, however, the sea of ink that currently sustains the industrial policy debate is of a quite different hue than that which engulfs the victims about which the debate swirls. And while much has already been written about industrial policy and its potential application within the United States (and no doubt much more will be forthcoming), there are still important questions that must be asked before this nation can seriously consider the adoption of such a radical departure in its economic management. This is, I might add, a proposition that is as relevant to the specifics of S. 849 as it is to the notion of an industrial policy in general. The brief comments that follow are thus not meant to deter the debate, but rather to better frame it within the realities of American tradition.

Industrial "Policy" Is In Fact a Complex "Process"

To begin, one should first recognize that there is no generally accredited definition of industrial policy. Like the "generally accepted accounting principles" of the CPAs, industrial policy can apparently mean whatever its particular advocates want it to mean. Unfortunately, too much of the literature couches discussion of the topic in the glowing terms of its various foreign successes, as found in Japan, France, Germany, or elsewhere. Yet what these commentaries often fail to distinguish with much clarity is that Japanese industrial policy, for example, is just that-- a Japanese program, just as French industrial policy is a highly particularized variant of a uniquely French historical and cultural development, and so on. As such, there is no common denominator of "industrial policy" that may be neatly or elegantly transferred and applied to American soil. Unlike a nation's currency (or at least most nations), industrial policy is not a fungible commodity with unlimited international mobility.

Indeed, it is perhaps erroneous to even speak of industrial policy at all in the relatively simplistic terms of mere "policy." A more appropriate designation for such phenomena might be "a cooperative process of long-term industrial management as coordinated and directed by state denominated agencies having both public and private sector membership." The operative term here is "process." What it implies is that in those nations that currently utilize industrial policy, the particular means of publicly managing the sectoral problems of the economy are not the result of any single policy (or even multiple policies), but rather the accumulated institutional outcome of a lengthy and complex evolution of affairs that has been uniquely defined by the host nation's own particular history and culture. When considered in this light, it becomes highly problematic whether the United States could ever adopt an "industrial policy" within the foreseeable future-- at least one that has even a vague resemblance to those more robust varieties found abroad.

Why is this so? Primarily because industrial policies at their core require a degree of cooperation and respect between the public and private sectors that so far has largely escaped the practice of business-government relations in America. Indeed, the very conception of Government within the United States mitigates sharply against the conditions necessary to such cooperation. Business-government relations here have historically been characterized as adversarial in nature, not cooperative, and as one result the state has never been able to develop or nourish the various mechanisms and institutions necessary to conduct a functional "industrial policy."

This is not, of course, news to anyone who has delved even slightly into the history of relations between business and the state in America. For example, the industry with which I am most familiar-- the steel industry-- has had an almost unbroken record of conflict and discord in its dealings with Government throughout the 20th century. While the reasons for this are both technical and complex, and perhaps somewhat idiosyncratic, what it reduces down to is a rich ideological tradition of private management of private economic affairs, and a serious limitation to the state's right or power to interfere into those affairs. While the dimensions of this relationship have obviously changed over the years since they were first articulated, there nevertheless has persisted a strong residual distrust and at times even disrespect for Government by industrial leaders. As a consequence, few serious attempts were made by the industry to improve matters. Those that were often resulted in little if any progress, due to the lawmakers' legitimate suspicions about the true motivation of the industrialists, as well as to the inherent weakness of the governmental apparatus to consciously reshape the dimensions of sectoral business-government interaction.

In the steel case, this long tradition of adversarialism has tended to exacerbate the recent decline of industry competitiveness. For example, the Carter Administration in late 1977 fashioned what might loosely be termed an incipient industrial policy for steel through publication of the Solomon Report. While the most salient ingredient of the Report was the so-called "trigger price mechanism" that would provide immediate financial relief from the deluge of imports, another key plank was the implementation of a tripartite committee (management-labor-government) that would consider a series of reforms designed to return the industry to international competitiveness. Yet other than the financial benefits that accrued to producers via the TPM, little resulted from the Solomon Report-- and certainly nothing of the magnitude of change envisioned by Solomon himself when he engineered the plan. The principal reason for this policy failure was the demonstrated lack of any substantive process by which the steel revitalization program could actually be carried out. The hoped for benefits that the TPM rightfully should have spawned-- such as technological improvement, industry reinvestment, and labor adjustment assistance-- never materialized. The tri-partite committee concept, thrust upon the industry actors not as the result of a long and healthy tradition of cooperation but rather as a singular and ad hoc policy of political containment, of course was not up to the task before it. Essentially, this attempt to fashion a politically motivated industrial policy without a requisite administrative process failed.

Similar problems plague other sectors of America's declining industrial base. The end result has been a comparative void in the establishment here of the similar institutions and mechanisms that animate industrial policy among our international economic rivals (such as, for example, MITI in Japan). These rival nations, lacking the profound historical legacy of conflict and distrust in the business-government arena, have instead fostered a rich tradition of cooperation between their societal economic actors, and in many cases even a tradition of respect and admiration for the agencies of public economic management. Thus industrial policies overseas are viewed not as the constrained output of traditional adversaries who reluctantly meet, on some ad hoc basis, to thrash out a suspicious and temporary truce, but rather as the result of equals coming together on a constant, consistent, and comfortable basis to work out coordinated programs of mutual satisfaction that will attend to the long-run needs of both the nation as a whole as well as particular industries within it. As I have noted, this is the outcome of an institutionalized process, rooted in historical and cultural developments, that to date has simply not been within the pattern of American public sector experience.

S. 849 as Industrial Policy: Pro and Con

If industrial policies will not take easily to American traditions of national economic management, as I have implied, does this infer that all such attempts should be abandoned? Hardly. As Senator Heinz's statement to the Senate during his introduction of S. 849 well attests, the magnitude of the nation's structural readjustment problems demands action. But while there is obviously a mandate to do something, the particular steps taken must be carefully measured and, I should think, the expectations must remain modest at this point in time. Absent the necessary caution, there is a danger that hastily entered into "industrial policies" might lead to unanticipated negative consequences that might later prove difficult to rescind (such as, for example, the highly transformative impact that liberalized PAC legislation has had on the electoral process).

With these caveats, let us turn briefly to S. 849 and its proposed remedies for industrial decline. First of all (and probably most importantly), I applaud the efforts of Senator

Heinz to establish a non-partisan program of adjustment assistance to our beleagured industrial sectors who suffer from import problems. It does no good merely to cast blame on past managerial inefficiencies or past Governmental policies when so many are now in need of aid. Furthermore, the fact that Senator Heinz's own State has been particularly victimized by economic change does not in the least bit reduce the necessity of a systematic national response to the problem. The Californias of today, it might be noted, could well become the Pennsylvanias of tomorrow unless corrective measures are soon undertaken.

It should also be noted that S. 649 is not representative of any undue public interference in the "free market" or with "free trade." Indeed, both of these abstractions are more appropriate creatures of theoretical economic texts than of modern-day economic realities. Like Professor Friedman's well-known lunch, effectively there is no free market or any free trade under the current regime of international economic relations (and a strong case could be made that, except for several brief interludes, there never has been any in the past century or so). Thus to force ourselves as a nation to ideologically adhere to some abstract and artificial principle while whole sectors of the economic infrastructure crumble is a folly of the cruelest sort.

But while some state action is perhaps advisable and necessary, I would counsel caution before plunging ahead. Acdordingly, while I believe that the general thrust of S. 849 is commendable, much of its detailed program appears to me to be in need of further refinement. Let me be specific.

(a) Is the ITC the proper administrative body in which to handle the adjustment process outlined in S. 849? I have doubts as to the efficacy of this particular agency to carry out such a pivotal function for industry revitalization. My doubts are grounded generally in the distribution of power within the Government, and more specifically in the limits of such a specialized body as the ITC to fully represent the myriad of interests that would (and should) require representation in any industrial restructuring or rationalization plans. The ITC, I would submit, both in its composition and mission, is inappropriate to this crucial task.

(b) Is S. 849 fully constitutional? As now written, the bill would allow an industry "adjustment plan" written under the auspices of ITC coordination to provide "relief from government regulations" for those industries deemed in need of such assistance. In light of recent Supreme Court rulings regarding the legality of the Congress to delegate its authorities, this may now be an unconstitutional aspect of S. 849. Other aspects of the bill might similarly be effected.

(c) Is there any meaningful public representation in the development of the "adjustment plans" as outlined in S. 849? Why is the ITC-- a body consisting of political appointees-- a sufficiently objective group to attend to industrial restructuring? Why would representatives from the Department of Commerce and Labor-- again, presumably political appointees-- be any more objective? Given the composition of the group that is to recommend specific adjustment assistance (which in S. 849 seems clearly to favor both industry management and its labor representatives), what is to prevent this narrow constituency from fashioning a plan that merely shields its participants from economic change, while shifting the costs of adjustment (and the shield) to the general public?

Where, that is to say, is any truly objective voice that will represent the best long-term economic interests of the nation as a whole? Can representatives from the ITC, Commerce, and Labor claim such independence? Moreover, what is to prevent the industry and labor representatives (probably more politically powerful than their cohorts) from making an "end run," so to speak, on the rest of the "adjustment development group" by going directly to the White House and seeking approval for their own privately negotiated plan--and then having the politically sensitive White House pressure its subordinate political appointees in the ITC, Labor, and Commerce Departments to approve the plan? These are real possibilities that should not be casually dismissed, especially in light of the bureaucratic traditions of policymaking in this nation.

(d) The prior reservation brings up a related point: how politically legitimate is the process of industrial readjustment as outlined in S. 849? Is the plan too "closed" for the American political tradition? Will it not invite litigation by those shut-out from the process who feel themselves abused by the restructuring outcome (there are numerous potential stakeholders here)? Indeed, is there any legal recourse for such claimants? As such, these reservations beg the earlier question: is the ITC the best administrative agency in which to embed this highly critical industrial restructuring function?

There well may be other caveats that one could reasonably raise about the process of industrial readjustment as outlined in S. 849. But the basis of my critique goes to the choice of the administrative body that is actually to attend to the administrative implementation of the program. Although I strongly applaud the effort to institutionalize the policy-making process, rather than leaving it to the ad hoc whims of changing political directions, I do not believe the ITC is the best candidate for this task.

Rather, I believe that a new agency should be created (or restructured) to manage the adjustment process of import impacted sectors-- and as well, perhaps, to help other sectors from falling into the decay stage that traditionally necessitates politically messy bailouts. Ideally, such a department would be the DITI (Department of International Trade and Industry) proposed recently by Senator Roth and others, only it would be less politicized than currently seems to be the case. If properly designed, this new department would appear to have a broad enough array of tools to successfully institute the "industrial policy" tasks that are at the heart of S. 849.

Conclusions

The key to a workable national industrial policy is the institutionalization of administrative process, thus decoupling the program from the one-shot, ad hoc actions that often result only in temporary band-aids for but a few of the effected parties (such, for example, as the TPM instituted in early 1978 for the distressed steel industry). S. 849 is, I believe, a step in the right direction in so far as it focuses on the need to embed the adjustment process (and, by extension, the entire industrial policymaking process) within a tangible agency of the Government that has permanence. Moreover, this bill is also on the right track in that it actively engages the relevant labor and management groups into the deliberations on more than a mere advisory role. Yet I would still question the efficacy of the ITC to carry out this program, for the reasons enumerated before. Instead, I would recommend that the specific procedures of S. 849 be reconstituted within a new Federal agency,be it DITI or some similar variant, and that this agency be given the political independence to achieve its mission unfettered by partisan interference that has too often characterized previous U.S. attempts to fashion sectoral industrial policies.

Finally, we should not delude ourselves that the institutional changes assumed under S. 849 will be easy to achieve or quick to take root. As I have noted, the degree of cooperation necessary to a workable industrial policy has generally eluded the nation in the past; to think now that it will come about overnight is wishful thinking at best. But on the other hand, the present demise of important sectors of American industry presents an historic opportunity to fashion a serious assault on the problems of institutional adversarialism that has for too long clouded business-government relations in this country. While not perfect, the basic thrust that animates S. 849 deserves a wide audience and critical and careful evaluation by all concerned parties. I strongly endorse the debate that I am sure this bill will engender.

Senator HEINZ. I have a number of questions. I will try to get to the heart of the matter, though, because I know we have three other witnesses who I don't want to constrain because of their schedules.

Let me ask Ken McLennan: On page 3 of your testimony and in your remarks you basically said that the policy response to our productivity problem should be more explicit but nontargeted in terms of industrial strategy.

Now, you may not be able to respond to this question, but Ed Harper, who is the assistant to the president of domestic policies, made a speech here in Philadelphia. A similar speech, I think, was made in New York. He gave the same speech in two locations. The speech was basically the administration's position on industrial policy.

Have you had a chance to read that speech or did you hear it?

Mr. TIFFANY. No

Senator HEINZ. I'm going to send it to you, and I would like you to tell me if that is a sufficient policy. It is fairly comprehensive. It is about a 25-page speech. Tell me if that is a sufficient policy for this country or whether we should go further and in which respects in your judgment.

I noted with some interest your reference to the Chrysler loan guarantee and how it was specifically structured by Congress to guarantee that the benefits or the profits of the help by the Government wouldn't float to the constituents of that institution or that entity, and that is true. That is exactly what Congress had in mind in saying to labor and management and dealers and banks, you know, "You not only can't take anything out of here; you got to help some as well."

You, on page 10 of your statement where you discuss temporary protection to help industries targeted for assistance, indicate that that could harm workers in other industries. And certainly it could and probably in most instances usually does.

TEMPORARY ASSISTANCE WITH IMPOSED REQUIREMENTS

If you granted temporary assistance but imposed requirements that, as we did in the Chrysler loan guarantee, all the benefits, all the profits would flow through to society during the term of that protection, would that prevent the harm of workers in other industries or would any specific harm in those so-called other industries be offset by benefits in still other parts of the economy aside from the particular industry benefiting from protection.

Mr. McLENNAN. I think if you have to give targeted assistance either to an industry or, in the case of Chrysler, in a firm, I think the concept that the Carter administration introduced was that there have to be tradeoffs for this. It makes a lot of sense.

Senator HEINZ. Actually it was Gerry Ford.

Mr. McLENNAN. I beg your pardon.

Senator HEINZ. Not on Chrysler, but on aid to New York City.

Mr. McLENNAN. You are right. That's right. Something similar was in the case of, I guess, Lockheed. They got some assistance earlier.

But I think that concept makes sense. And clearly if you were talking——

Senator HEINZ. That's not my question. I have asked you a slightly tougher question, not whether if it is granted, whether that makes sense. I have asked you the question whether it mitigates the problem that you say is the problem with temporary assistance.

Mr. McLENNAN. It does—it would help depending on the conditions you apply. For example, it is very difficult, especially for business groups, to talk about it. But business groups on this issue are completely split.

Senator HEINZ. I have noticed.

Mr. McLENNAN. And they should be split, because some industries are going to gain and some industries are going to lose.

Senator HEINZ. To give you an example how some industries are split, when I went up to Detroit to talk about S. 849, Chrysler and Ford are for it. General Motors is against it. And Chrysler and Ford say the reason General Motors is against it is with foreign import competition helping GM, GM figures they can either drive Chrysler or Ford out of business or keep them so weak they don't have to worry about them.

Mr. McLENNAN. I think it would mitigate the problem. I don't know, for example, if it would exactly reduce the damage done overall.

The problem is that you make a gain for a couple of years, but after about 4 or 5 years what you really do when you restrict that trade is you reduce your GNP; and so that the whole overall level of employment will decline.

Senator HEINZ. Can I interrupt you there?

Mr. McLENNAN. Yes.

Senator HEINZ. Should we repeal then our laws that are so-called adjustment laws? We have a bunch of them on the books. Should we repeal them? You made an argument against the escape clause, sections 201, 202, and 203. That is an adjustment clause. That proceeds from article 19.

Mr. McLENNAN. I'm not an expert on international trade agreements and I think you do have to have some escape when a country feels that there is some, I guess, material injury to what the concept is.

Senator HEINZ. That's right.

Mr. McLENNAN. I think you have to have that kind of protection.

Senator HEINZ. Was that for political reasons or for economic reasons?

Mr. McLENNAN. I think it is for—I think it is mostly because of political reasons, because every country is going to—we are never going to get completely—we never have had completely free trade, and countries are going to have something that they perceive in their national interest generally, whether it is protecting the communication system or whether it is their steel industry.

But let me go back to just your point. If we could get agreements that the unit cost of production—for example, steel—would continue to reduce, I think you would substantially reduce the damage done to other industries.

Now, that is a very difficult problem, and it is one that I don't particularly—what that means is that steelworkers are going to have to take a real cut in salary and a substantial cut. And if it was me, I wouldn't like that. But there is no way you can have—other American workers will not support it. Society won't support a growing differential between the average steelworker's wage and the average manufacturing worker's wage.

CONTRACT CONCESSIONS FOR IMPORT PROTECTION

Senator **HEINZ**. Let me throw a fastball down the middle or, as the National League did last night, a lot of hanging curves.

I have met with a number of the United Steel workers, both international people and local people; and I have told them that if S. 849 is enacted, that they can rest assured that there would have to be some substantial contract concessions in order for the industry to get the import protection that would be envisaged under the legislation.

They then endorsed the legislation. They endorse the legislation because they believe that they at least would get something for their contract concessions.

Mr. **MCLENNAN**. Well, I think that's encouraging.

Senator **HEINZ**. A healthier industry.

Mr. **MCLENNAN**. I think it is encouraging, because it is very difficult for a union leader to tell——

Senator **HEINZ**. There had been some contract concessions in the steel industry, and there is not necessarily much for steel top labor leaders to show for it. They don't have anything in writing that I know of from the industry saying, you know, we are going to keep you all employed forever. This makes it a lot easier for labor people in the high wage trade industry. Nothing will help Chick Chaikin and his people in this regard, because his people are already at the bottom, just there at, or slightly above the minimum wage.

But in the hot capital intensive high labor cost industries this will make it easier, strangely enough—or not so strangely if you think of it—for labor to make contract concessions. They will have something to show their membership.

Now, I guess the reason I asked you the question I did is to try and see if we can't deal with the theoretical objections you raised to some kind of more forward going industrial policy.

It is also interesting to me that you mentioned lowering unit cost of production, because it is my view that the way the decisionmakers and administrators of S. 849 who come and evaluate, they plan, they have to have a method of making a decision as to whether the self-help plant is good enough.

And my admonition to them is say yes or no; and, if it isn't good enough to say no and if it isn't good enough to say yes, then the question: "Gee, Senator how are we supposed to tell?"

And the answer that I would give them off the top of mind is get the very best projection you can of output labor costs, of output costs, unit costs absent, you know, the invocation of S. 849 and then superimpose the plan on that and see how big a drop you get as a result of what was proposed in the plan in unit costs. And if it seems substantial enough to you relative to international competitive conditions, approve the plan. If it doesn't, tell them to go try something else, either some other section of law or another plan.

Mr. **MCLENNAN**. That seems a reasonable criteria if you can get your unit cost of production down, whether it is by improved productivity or by labor and management working better together to improve——

Senator HEINZ. I think Government should stay neutral on how those costs of production are to be reduced. And, mind you, since inflation is always with us apparently, the question is reduced versus what they would have been. It has to be a relative analysis, because other countries are going to experience inflation. We are looking at the end of a period which is 3 or 4 or 5 years out there.

Having said that, do you think S. 849, the concept—not the bill, the concept in S. 849—is it sounding better to you?

Mr. McLENNAN. I think it does sound better. The one thing that I think——

Senator HEINZ. I don't want you to think I'm trying to influence you.

Mr. McLENNAN. No; I realize I'm going to share it with my colleagues to get a more detailed response.

But one thing that bothers at least me personally and I think the trustees, we have to be very careful when we intervene in their collective bargaining system.

Senator HEINZ. That's right.

Mr. McLENNAN. It is always much better if labor and management can work out these problems themselves. I think they should change their bargaining structure and could get away from phantom bargaining and so forth. And that is up to management and labor.

Senator HEINZ. Let me ask both of you this question. I would, by the way, agree with what you just said. Assuming there is validity to the basic tradeoff in S. 849—by the way, it is really not as dramatic as you think it is. We grant import relief all the time around here. We just granted some.

NEED SELF-HELP PLAN TO REDUCE PUBLIC COSTS

The problem is the public is never guaranteed that it is going to get anything out of it. All we are doing is saying that at certain times import relief is a little easier to get. Let's make sure the public gets something out of it. It's not all that dramatic, maybe just a lot of common sense.

The question is: Is the best way for the administering body to judge the effectiveness of the self-help plan what it will do to reduce human costs, and is there any reason if that is the best way that that can't be done technically speaking?

Mr. TIFFANY. Is there any way that it can't be done?

Senator HEINZ. Is there any reason that it can't be done?

Mr. TIFFANY. Theoretically I see no reason why it can't be done. But one of the problems, I think, is that, again going back to the comments I made earlier, if we leave it up to industry and labor to resolve their own problems, they are going to tend to resolve them in their favor and not in the favor of the quote, unquote, public interest. This is normal human behavior. It is simply the way people operate, as Ken referred to it earlier.

Senator HEINZ. Let's assume for the sake of argument there is a clause in the legislation that admonishes the administering body that the benefits that flow from this deal have to flow through in the way Chrysler codicils forced them to flow through to society in general, if there is any benefit to the management and workers, it is indeed in existence, indeed stronger, and more competitive at the end of the period of relief.

And, you know, they are going to have to defer their gratification for the 4- or 5-year period that the import relief would probably be granted. And at the end of that time they are whatever it is they have chosen to make themselves and what they have had to choose to make themselves is in a sense through abstinence a much fitter set of entities.

Mr. TIFFANY. As I understand it, the mechanics of the system now as you are proposing in S. 849 are such that the adjustment group would come up with some sort of rationalization, restructuring plan, whatever with the public interest certainly as much a part of that as the immediate interests of the foreign.

Senator HEINZ. Yes.

Mr. TIFFANY. Before import relief is granted, they would all have to agree to this plan. Everything would have to be in agreement. The import relief would be granted, and then the program of restructuring or whatever it is would be implemented.

Senator HEINZ. That's right. If it wasn't implemented and agreed to, the import relief would be revoked.

Mr. TIFFANY. And I see nothing wrong with that working. I think theoretically it is fine. But, again, when you look at the public representation on that, you have individuals and you have agencies who are going to be subject to tremendous pressures, and probably the pressures that the industry or the union can bring to bear in the White House are going to be substantially greater than the pressures that the public interest representation can stand up to.

Senator HEINZ. I have noted that point, and you are not the first person to make it; and I think it is a valid point. The first person to make it was Mr. Solomon, who should know.

Mr. TIFFANY. Who should know.

But when I talked to him about it, he said, "This was not my plan." He says, "The TPM was a minor part. I wanted a major restructuring."

Again, it goes back to this larger question, the way politics are done in this country. It's like sausage sort of. If you saw how it went along, you wouldn't want any part of it. That's the way it tends to work.

The question is: how do we get above that, because an industrial policy if it is to be more than ad hocery, it requires a level of operation, a degree of cooperation that unfortunately historically has not been part and parcel of American policies in the past.

You have to make a start somewhere; right? I agree with that. In that respect I like the notion that is being advanced in S. 849.

Senator HEINZ. We have been explicit about the notion of culture in a newer sense of the term. The term corporate culture was invented well after I went to the Harvard Business School. It has only been big there, I am told, for the last 2 or 3 years, yet it is a very useful notion.

And the culture of our society and the culture of the institutions in our society, be they corporate, governmental, community, or otherwise is a powerful factor; and I think both of you have in your own ways outlined that an industrial policy in the United States has to be consistent with a large number of rather fundamental both societal and institutional values.

I'm going to try and make sure that this or any other industrial policy is so consistent. And, indeed, one of the reasons I used the word self-help is that that is one of the great cultural notions of our society.

You know, it is the old work ethic. As one Catholic Italian said to me when I was running for Congress, he said, "Congressman, what's made this country great is the Protestant work ethic."

Mr. TIFFANY. He could have been Jewish too and said that.

Senator HEINZ. And I think both of you have been extremely helpful both to me, and you will be helpful to all of us in Congress for giving us a considerable amount of insight into what other countries are doing. There are some questions I will submit to both of you, I think, following up on your more detailed testimony. But I think you have been both extremely helpful. I thank you for your time and for your excellent testimony.

Senator HEINZ. Our next two speakers are John Latona and Sol Chaikin.

Chick, I want to thank you very much for being here. I know how busy you are. Please proceed.

STATEMENT OF SOLOMON CHAIKIN, PRESIDENT, INTERNATIONAL LADIES' GARMENT WORKERS UNION

Mr. CHAIKIN. Thank you very much.

If I may, I would like to start with a short comment which relates to the small jest that you just told us.

You may know that I spent some time in Massachusetts as a resident of that great State, and I accompanied an aspirant for the position of United States Senator. He then 21 years ago was elected, and he is still in the Senate now. You might guess who I mean.

Senator HEINZ. That narrows it down.

Mr. CHAIKIN. And outside the plant gate we were campaigning and electioneering and the aspiring Senator who is not yet elected in the primary had been attacked unmercifully by his opponent as never having worked a day in his life.

And as we were handing out the literature and one thing or another, one of the men came out—and he happened to be Italian Catholic as well—said, "Senator, I know that your opponent has been belaboring you and attacking you alleging you haven't worked a day in your life." He said, "Senator, I'm here to tell you you ain't missed a damn thing."

So I guess that will take care of the American work ethic or at least as to how we perceive it.

As you know, Senator Heinz, I have been terribly concerned for many years over the lack of a rational policy of fair trade. And that impinges on obviously what I consider to be the need for some process as Paul Tiffany has related through the eventual evolution of an industrial policy for the United States.

I have traveled widely over these last number of years attempting to persuade opinion leaders that they ought to begin thinking about the problem. I have no magic wand. I have no magic formula. But I have tried to isolate some of the problems that the present day economy confronts; and, if I may, I would like very quickly to illustrate what I mean by the problem.

PRESENT DAY ECONOMY PROBLEMS

At this present time industry is operating at somewhat less than or at or about 70 percent of capacity. At this time the value of about 15 percent of the purchasing power of the work force in America has been withdrawn from the market.

The Bureau of Labor Statistics tell us that 10.1 percent of the American work force is unemployed; but you and I know, and the Bureau on occasion, rare occasion, will indicate that about 2 to 2½ percent of the work force is no longer counted as being in the work force because they are discouraged, their benefits have run out, they are frustrated and aggravated at their inability to find work, and they live in many communities where they are absolutely aware of which companies are laying off and which companies are hiring.

But they are no longer actively seeking work, and as a result the Government doesn't count them. They put a red marking pencil through their names as though they were obliterating this human being.

In addition to that, it is variously estimated that 6 to 6½ million workers in the United States are on short time. They are ready, willing, and able to work a full week; but they are unable to have that kind of work. And the estimate is that that is worth about 3 percent of full unemployment for the entire work force and, if the mathematics is correct, somewhere approximately 15 percent of the value of productivity. And their purchasing power is just withdrawn from the market.

In addition to that, we have the problem of trade deficits. The merchandise trade deficit in the United States is variously projected to be about $60 to $70 billion for the year 1983. And that obviously reflects not only on the ability of the American industrial community to sustain itself but obviously relates in terms of human distress and trauma to the numbers of Americans whose jobs that represents.

And, fourth, we have the enormous budget deficits for fiscal 1984 and the other years ranging up to $200 or more billion.

When we talk about the budget, its impact on the national economy, and the well being of the American community, we talk in terms of what it costs to service the accumulated budget deficit. And that cost is well over a hundred billion dollars per year. And these costs are growing at or about the rate of about $20 billion per year. And I'm constrained to imagine how much of a constructive contribution to the nation's economy there would be if we had available the use of such funds in social services, in job creation, in rebuilding the infrastructure, et cetera.

LONG-RUN DANGER

What is long-run danger if nothing of substance is done? Labor intensive industries and smokestack industries are being wiped out or severely limited, and there is increasing evidence that high-tech industries will—surely they can—move abroad. The danger exists with raising the level of full unemployment, the concept of full employment from 4 to 7 percent unemployment, which is apparently the number that the chairman of the Counsel of Economic Advisers is beginning to use.

But if that number increases inexorably to about 10 to 15 percent, then where is the American community? What will happen to our highly flaunted American living standard, the envy of the world for the past century? Are we in danger of reaching a stage where we homogenize living standards in the United States with those in Third World countries? And can the United States, is it possible for us in the relatively short time to become in terms of high unemployment and wide disparity between the wealthy and the rest of the population somewhat akin to a Third World country? How do we cope with these problems if there is some agreement that one or all of these are serious problems?

I agree completely with Paul Tiffany that industrial policy will not be arrived at by pressing a button or setting up an econometric module and putting a lot of figures in and waiting for the outcome. I think it is a process.

And I want to compliment you for introducing your bill, S. 849. And I don't want to go into the merits of the bill except obliquely as I may make some comments or perhaps respond to some of your questions.

I think it is essential, the time is long overdue, that we have a national discussion focused on this general problem. As you know, I have taken every opportunity to provoke discussion, and I think if the opinion leaders of the United States zeroed in on the problem—I don't care which approach they take or where they come from—rational human beings with the best interest of this country ever present limiting discussion and guiding discussion, I'm absolutely persuaded that we will begin a process that will make some sense to the American community without doing violence to American cultural institutions, without doing violence to our relationships with the other countries overseas.

The reason I say it is a process and the reason I say that we have to have a wide-ranging discussion is exemplified, for example, by the testimony that my friend from the Committee on Economic Development, CED, put forward. Nowhere in the testimony are the words textile, apparel, or clothing mentioned, and yet this is an industry that employed traditionally one out of every eight manufacturing workers in this country. Up until 5 to 7 years—within the last decade surely—they employed about 2½ million workers. It's an important part of the American manufacturing work force.

Nowhere is there mention of the problem. And all of the testimony that flowed from it is not applicable in terms of proposal or objection, not applicable to our problem in textile, apparel, or clothing.

And the suggestions that are made as part of a process of becoming more competitive strengthening the capital intensive industries of auto and steel, which was concentrated upon, really have no relevance to the problem of textile, apparel, and clothing; very little relevance.

So the process has to take count of the differing industries, the nature of those industries, and the real world in which those particular industries operate. And so the process very carefully—as your bill indicates, there will be an opportunity for industry and labor and Government, public people to be involved in looking at what they already know and to see whether on the basis of their current knowledge and the discussions among them, they can prepare for and identify things perhaps with which they're not too familiar at the present time.

And so the first principle is that we have to look at our economy industry by industry to see if we can identify what the special problems are, to see what the hurdles are that they confront from international competitiveness, to see what facets on a cooperative stance can be brought to bear on the problem.

In capital intensive industries it is altogether possible that the workers surely should make a contribution, that they may realize that in return for a greater opportunity for job security, a greater security in terms of national and international competitiveness, it would warrant some retrenchment on their party and certainly as a quid pro quo. For industry promises to reinvest more of its capital, more of its profit, not to go far afield and use as United States Steel did whatever capital is available to it in the form of self-generated capital or borrowed capital and go out and buy an oil company. And the Government might be induced obviously to engage in some processes which would seek to make possible greater competitiveness and opportunity.

It is essential that we look at this national economy almost on a microbasis of industry by industry and see just exactly what the problems are.

Let me very quickly say for the record what you already know, Senator Heinz, that in the textile, apparel, and clothing industry the problems that have arisen do not relate to the fact that our employers have become fat, lazy, lethargic and refuse to reinvest any of the small profit margins that they have had traditionally over the years.

The apparel industry particularly is the lest vestige of free, democratic, competitive capitalism in this country. It is made of tens of thousands of entrepreneurs who are constantly at each other's throats competitively for a share of the consumer's dollar.

The products overseas are made by Americans.

Senator **Heinz**. It sounds like politics.

Mr. **Chaikin**. It may very well be.

The items that come into this country from overseas are made by American designers. The styles, the fashions are American created, American creativity. The patterns, the sizes are American sizes, not sizes of the people in Southeast Asia where the garments are made.

The apparel is made specifically for the American and the Common Market economies. We use state-of-the-art technology. Nobody can accuse us of not availing ourselves of the inventiveness of the American genius. We invented robots, but the Japanese put them in place. We use state-of-the-art technology. Our technology has been shipped overseas. Our software—the method of production has been shipped overseas. In most cases our capital has been shipped overseas.

LABOR OVERSEAS HIGHLY EXPLOITED

The only thing that is variable is the cost of labor. And they have put together American capital, American technology, American software with the labor overseas highly exploited, unconscionably low paid; and in a labor-intensive industry such as ours it is competition that cannot be met except through one process.

If we were to decide as a matter of national policy to homogenize the standard of living of U.S. workers in textile, apparel, and clothing and the standard you alluded to, these are workers in the lowest 10 or 15 percentile of American wages across the country. They are not the fat cats. We are not talking about people who can think in terms of demeaning and lowering and derogating their current standards which are low—very low—by American standards.

You want to homogenize a $5-an-hour worker, $5.50-an-hour worker in the Northeast part of the country with a 16-cent-an-hour worker in Red China with a $1.08-an-hour worker in Hong Kong with a 38- to 40-some-odd-cent-an-hour-worker in South Korea. Well, OK.

But unless we decide to go that route, we have to go another route. And the route that we propose very simply for our industry is market shares. If countries overseas and particularly in the Southeast Asian countries by and large and in the Caribbean countries and in Latin America, if as a matter of national policy they decide to exploit their workers, they don't permit the formation of free trade unions, the social welfare policies of the countries are archaic, are nonexistent, and certainly nonresponsive to the needs of human welfare, if that's the way they want to operate their societies, we don't have to offer to them free access to the greatest market in the world, the domestic American market.

What has happened in the last 20 years is that from an import penetration of hardly 4 percent of the American domestic market, it has boomed up to where in 1982 it was about 42 percent of the domestic American market and we project in 1983 because of the tremendous surge of imports of textile, apparel, and clothing in the first 5 months of 1983 where it has increased at least 22 percent on average over and above the first 4 or 5 months of 1982 an import penetration exceeding 50 percent of the American domestic market. That means simply that half or a little more than half of the value of all ladies' and childrens' apparel sold over the counter in the United States will have emanated from countries overseas.

Now, you have to compare that with the great outcry that arose when there was an import penetration in automobiles, 20 percent going to 23 percent, and where the high water mark of importers of automobiles was about 27 percent of the domestic market, of specialty steel where it is about 20 percent of—generally steel across the board rarely exceeds 25 percent.

And this in an industry which together, as I indicated historically, employed 2½ million workers. We have lost 650,000 to 700,000 jobs in textile, apparel, and clothing in the last decade.

If nothing is done, if there is not massive intelligence interpositioned by the Federal Government which controls our borders and controls what will come in and possibly what goes out, if things are permitted to go on a pace, there is no question that in the next 5 or 6 years we will lose four to five hundred thousand jobs and over the next 10 to 12 years about a million jobs.

And, now, in order to focus in on the severity of the problem, I think we have to understand what these jobs are and for whom they are available and why it is so necessary that the American community provide these job opportunities.

By and large, the workers in these industries, Senator, while they are trainable and educable and can learn by precept and example and become highly skilled by working and by doing, they are just not the kind of an industrial force that's readily available for high tech. They cannot read blueprints. Many of them do not have a high degree of scholarship. Many of them do not have the language. Many are recent immigrants into our shores.

THOUSANDS OF IMMIGRANTS SEEK WORK

Most Americans forget we are the most liberal country in the world so far as immigration is concerned. And many of us don't really think in terms of the large numbers who come to our shores seeking opportunity.

They don't come because they want to be on the welfare rolls. They come because they hope there is work, there is hope for liberty, for freedom to practice their religion without hinderance. They come for many reasons but mostly for a chance to live a little better here than they have in their home countries, the hundreds of thousands of Vietnamese, the hundreds of thousands of Cubans that come to our shores, the hundreds of thousands of Asiatics from Southeast Asia who come to our shores for the liberalization of American immigration policies.

The many new Americans who have come to us, the Hispanics who have come from Puerto Rico—and I'm not even talking about those who come without the legal papers and basis, and I'm not discussing the role of the undocumented workers in the American industrial society or what that portends for the future. That's a separate and distinct problem.

But we offer in textile, apparel, and clothing a threshold industrial opportunity for workers who would not otherwise be qualified for most of the other job opportunities in service industries except in the back end of the hotel or the back end of the restaurant to clean, to fetch, to carry, and things of that nature.

But in manufacturing ours is a principal threshold in industrial opportunity. It is labor intensive; and it is not only textile, apparel. and clothing, but a number of other products that are made in other industries which can likewise be categorized as labor intensive.

It is necessary that we have them. Not everybody in our community has an IQ of 90, 100, 110, 130, 140. Not everybody can enter the professions. Not everybody can be part of an automated office. Not everybody is born with the adherent talent and ability to reason and the capacity to be creative.

We have to have work in our community suited for Americans who have, let's say, a more limited capacity, a more limited ability, cannot compete in an open, free, full, fair race with those who are plebists and those whose minds are agile and creative.

And these jobs have to be retained by us. We have insured, Senator Heinz, our own Third World within the United States of America, our minorities in the center cities.

I can take you to the apparel industry in Philadelphia and show you that here in this city about 70 percent of the members of our union are black with a small proportion of Hispanics. Hispanics are coming into Allentown and Easton, as you may know, in the major cities where garment production is being done.

With the destruction of the apparel industry I don't know what Center City residents and employees would be doing in San Francisco, in Los Angeles, in New York City, some in Chicago, not a great many.

Then we must not lose sight of the fact that throughout America the apparel industry is situated in small communities as it is throughout Pennsylvania. And these are communities where when the apparel industry goes down and when the factory closes up because an employer has impaired his capital and cannot continue because of the extraordinary competitive position of garments that come in from overseas, workers are left high and dry. And these are not necessarily workers of limited capacity. They are trainable and educable. They could go into higher tech. They could be trained in office automation.

But there is no policy, there is no direction, there is no guidance, there is no suggestion that in order to take up the slack of that unemployment, that other industries which are burgeoning, which are increasing, which can use additional production, no guidance that they should go to those areas where the surplus labor is found.

Quite the contrary. What has happened because we have not engaged in the process and there is no policy and really no large debate nationally and no intelligence brought to bear on this problem is simply that many of the corporations, the great corporations in America that have been increasing their market share in the world that have been able to bring out new products and put them on manufacturing screen, have found it to their great advantage to open up plants overseas.

MULTINATIONAL CORPORATIONS INVESTING OVERSEAS

The multinationals have shipped their Cadillac technology overseas, have taken advantage of the subsidies that are offered by developing nations and the protections that are offered by developing nations. They have taken advantage of our tax laws in terms of paying taxes on the profit. They have opened up the most modern plant and equipment in just as many sovereign nations across the continent.

The story of IBM, the story of General Electric, the story of many major American multinational corporations investing overseas is just too well known to too few Americans but well known to a small number of Americans for me to just relate at the present time.

We have not gotten the share of new plant and equipment in the United States that even those of our successful economic units have had to build. And the building has gone elsewhere. The one variable around the world now—with a free flow of capital, with the free flow of technology, with the free flow the software the only variable around the world is the cost of labor.

And the comparative advantage that David Ricardo talked about a century ago and that Adam Smith wrote about a century ago exists today, but it is not the comparative advantage of which they were aware a century ago.

POVERTY USED AS A COMPARATIVE ADVANTAGE

The comparative advantage that these developing nations have and other nations around the world have vis-a-vis the United States is poverty.

Senator, poverty is their comparative advantage. And we're not going to overcome it, because the developing nations do not permit the institution of free trade unions, oppress the people in their natural desire to live a little better.

The fact is that our internationalization of the factors of production have merely helped be a lead to these other countries to live a little better.

And the statistics will show that over the last 10 years where the gross national product of some of these countries has increased somewhat, that the share of the poorest of them has not increased, that the share of those who own a means of production, the elites of the countries, the politically well situated, the governors of the countries have improved their own status.

So we haven't even improved the lot of the average person overseas by sharing our inheritance with them, by sharing our ability to create and our ability to build and our ability to provide work for people.

So it is necessary—and I took a little longer than I had planned to discuss the problem of textile, apparel, and clothing. And I did so because I want to impress upon you, Senator, of what you already know but through you to your fellow Senators and to the other opinion leaders of this country to whom you have access, to impress upon everybody who is concerned that we have to look at this industry by industry and we just can't speak in glittering generalities and we just can't from the problem of autos and the problem of steel derive a general formula which may be applicable across the board.

There is nothing that apparel workers—that nonunion textile workers, not apparel workers who earn hardly $3.50 to $4 an hour can give back in order to make their industry more competitive.

There is hardly anything that the textile and the apparel and clothing industries can do to make themselves more efficient. They are already as efficient as countries overseas, as industries in those countries overseas.

So your suggestion that a mix of formula, a mix of approaches may be necessary, I heartily concur; and I believe it is essential.

Now, beyond that obviously some industries are going to have to be restructured. There is excess world capacity. There is excess capacity here. But together with the restructuring is that we have to understand that we are talking about living human beings, not just talking about closing down a steel mill or closing down a facility or replacing one assembly line with another assembly line. We have to bear in mind that every one of the decisions that is made in that regard will reflect itself in human distress and trauma and dislocation.

And when we begin thinking of the restructuring of industries, we have to talk side by side with as great a priority in terms of how do we recycle the human beings, how do we restructure the human beings, or what we do to the communities that will suffer when we just clamp down and shut down on an industry.

And the story of Johnstown, I'm sure, is upper most in your own mind. You have spoken to steelworkers there. You may have spoken to some garment workers there, because strangely the largest employers are the apparel industry and the steel industry; Bethlehem obviously the single largest employer. And both industries at the same time are in a state of distress and great unemployment, and that community is just battered. And we have to bear that in mind when we talk in terms of restructuring.

I'm in favor of investment in state-of-the-art technology and help in those industries which don't have the capital for it, but obviously with some quid pro quo we are going to help the steel industry. They shouldn't be going on some other adventures, you know, in using capital. It partially came out of the effort of so many tens of thousands of workers and executives and investors in steel to use some of that product in going out to buy other companies unrelated to steel.

I think an RFC-type agency could be useful in offering soft loans to those corporations which cannot by their nature finance themselves presently or in the near future.

RETRAINING AND JOB REPLACEMENT IS ESSENTIAL

I think that retraining and job replacement in the stricken communities is essential. The American community is not as mobile as it used to be. It is nonsense to think that the 10,000 steel workers in Youngstown, Ohio, are going to pick themselves up and go traveling around the country looking for some suitable work.

I think it is necessary that we target retraining and targeted job replacement and do it by encouraging and guiding employers to come into those communities. And you can do it through subsidies, you can do it through training subsidies, you can do it through tax benefits, because eventually the entire public will be the beneficiaries of reestablishing these stricken communities and putting workers to work.

I think we can encourage joint research and development far more than we have now. Admiral Lindmund's new company is an interesting development, but not every corporation is a giant corporation that can afford to be a partner in that kind of activity.

And while you indicated that the Federal Government provides billions in research and development, if necessary it can provide a few billion dollars more in addition to what it does now because most of research and development is specifically marked for defense activity. And, of course, if there is civilian spinoffs or applications, new developments can be used in civilian or industrial operations.

I think it is necessary as part of the process that we reduce interest rates. And here I'm no financial expert, and I have a very simplistic view of it. Perhaps it is just not admirable to confess it. But I rather like the comment that I heard some people make that if Paul Volcker and the Federal Reserve knew how to raise the interest rates, then by God they ought to know how to bring them down.

And so I will shift the responsibility for doing it to those who have the responsibility to look after the financial areas of our Government and its subdivisions.

I'm hardly in favor of job creation as part of the process. What I'm talking about and what Paul Tiffany spoke about, what your bill suggests—and I welcome it again and again and again not necessarily so much as the substantive provisions that are now in that and as you yourself say some rough edges and it has to be fleshed out perhaps, but I welcome it whole heartedly because I consider it to be a catalyst in this need for discussion and the need for focusing in on this problem, to think seriously about it, to debate the component parts.

I don't believe that anything I have said is just the absolute end-all and be-all or anything like that. But my function has been to introduce a facet of the problem which has to be considered. And in this process that Paul Tiffany referred to, there will be room for consideration, special circumstances and special needs and special problems.

Senator HEINZ. Let me reiterate, as I think you know, because I said this when I introduced the bill—I think I made the same declaration when I spoke to your legislative conference in Washington—which is: This bill, S. 849, is not aimed and cannot help industries that are only marginally capital incentive and particularly by low wage rates.

You are right. The comparative advantage you are fighting against is poverty, and my bill does not deal with international poverty. It doesn't make the people in Taiwan or the People's Republic consumers and high wage rate people. Unless it did that, it couldn't help.

Mr. CHAIKIN. Right.

Senator HEINZ. So I think your point is extremely well taken. I emphasize it for the record, that whatever we do develop in this country in the nature of an industrial growth strategy will have to have many components.

Mr. CHAIKIN. Right.

Senator HEINZ. And I believe that my legislation, important as I think it is—because I think basic industry is very important to us all—is certainly only one component.

Mr. CHAIKIN. Well, I thank you for that, Senator.

Very quickly, I think that while we are waiting for this process to unfold, while we are waiting for there to be a reasonable consensus in terms of national interest and national policy, it's important that we do get into some form of job creation.

We just can't permit all of that distress out there to keep mounting and mounting especially insofar as it is said out of Washington that we are on the edge of a kind of recovery, that everybody—at least the official pronouncements are quite optimistic about the direction in which this economy is going. And yet at one and in the same time everybody in authority indicates that there's going to be high and persistent unemployment hardly getting down much below 10 percent at the end not only of 1983 but into 1984 as well.

And so there are so many things that we ought to be doing, and illustrative of what we ought to be doing unfortunately is the tragedy that occurred in Connecticut just 1 week ago when part of a bridge fell down, a bridge that was hardly 25 years of age.

REBUILDING THE INFRASTRUCTURE OF THIS COUNTRY

I don't want to use the overworked word infrastructure. We have an old infrastructure in this country. And it can be useful work that people can be put to, not just boondoggling, et cetera, et cetera. It will be helpful, again, to keep the wheels of this economy going if we find work for people rebuilding the infrastructure of this aging country.

Thirty years ago it is estimated that 4 percent of the gross national product was spent on the infrastructure, roads, bridges, public structures, et cetera, et cetera. Today it hardly amounts to 2 percent for a bigger, richer, older country with more people using all of those facilities. And we are spending only half as much money. We can just create real jobs in that regard and with it some of the example that Philadelphia has and some in your own area of Pittsburgh where you rebuilt over the last 20 years the core of the central part of Pittsburgh and Philadelphia, of which this building is illustrative.

There are so many other cities around the country that can use that kind of revitalization and help, and we ought to be doing it.

Full employment has been the goal of each nation in the postwar years, and in large measure this was accomplished in the 1970's. Now, simply stated, so long as there are nations, states, the primary obligation of each nation is to keep its people employed. It's their national interests, and they inexorably drive toward the fruition of that concept.

And the rest of the world, primarily the industrialized sector, has attempted to do this with the possible exception of the United States and Canada, both of which continue to practice, "a policy of free trade."

And I am well aware and I am one of those who has stated for the last 10 to 20 years that free trade as a concept and reality has hardly found a place in the world's economy in the last 100 years. It is a slogan, one of which people are enamored.

From a practical point of view it has rarely existed over any period of time. And I am quite aware——

Senator HEINZ. You are not going to get any argument from me.

Mr. CHAIKIN. I am quite aware that here in the United States there is Government and Federal interposition in the free play of, quote, market forces.

But on a comparative basis, when you compare us to Great Britain, us to France, us to the Common Market, and compare us to Japan, particularly among the industrialized nations, the United States and Canada can reasonably be said to practice the policy of free trade.

EUROPEAN NATIONS PROTECT THEIR WORKERS

European nations, you know, protect their workers. President Mitterand in a democratic country just issued an order that all of the Japanese electronic consumer products would come in through central France where they have one and a half customs inspectors, and as a result all the stuff goes on the docks and is not permitted to come in. You can't hardly find a Japanese car if you stand on a street corner in Paris and watch the cars go by.

The same thing is true of a number of other, you know, free trading countries, the reported rollback of textile, apparel imports by the Common Market countries where they just muscled Hong Kong, Korea, and Taiwan.

We have to embark on the process of calling to the American community's attention the need for a rational policy of fair trade as an important component of an industrial policy. And we may never get to the end of that process, because the process will change as indeed conditions change.

It may very well be that my successor some years going forward will sit before you whether in your present capacity or some other capacity——

Senator HEINZ. It's always possible that you may be sitting before my successor.

Mr. CHAIKIN. I doubt that—and say to you that circumstances in our country and the evolution of the industrial process in this country and the way in which the world's economy has been somewhat reshaped or refitted, that it is altogether probable that we need no manufacturer of textile, apparel, and clothing in the United States.

It is altogether possible 20 or 30 years hence that the children of garment workers today will either not want to come into the industry or find themselves qualified for that brave new world that others including IBM are pointing us toward.

It may altogether be possible that the level of scholarship of the then American work force will be such that to fetch water and chop wood is no longer necessary as a job opportunity.

And so I say that this process upon which we had better embark and where you are acting as a catalyst toward the discussion is welcome. We had better engage in it as quickly as possible. It will take some time to find reasonable acceptable consensus; and the process may never end, because I don't think that the world is so constituted that it will remain static. Everything around the world will change. And apparently it seems to be changing a great deal more rapidly in the last decade than perhaps it changed for the three or four decades before that.

We look forward to that change, we welcome the change; but we had better be prepared for it.

Senator HEINZ. Chick, I thank you for some very profound remarks. I want to reiterate my appreciation to you for being such an outspoken advocate of a particular facet of the industrial policy problem. You can rest assured that those comments will be taken to heart just not by myself. I have heard them on more than one occasion, but by other members who may not have been so widely exposed.

Our last witness is Jack Latona. Jack bears the heavy burden of being a classmate of mine in college, and it had nothing to do with his being here. It was quite coincidental. He has worked very hard on the famous Houdaille petition. Unfortunately, that petition was ultimately denied by the Reagan administration.

Basically that petition alleged a pattern of Government support for the Japanese machine tool industry. And more than that I'm not going to say because I haven't read the petition in its entirety; and, second, I don't want to preempt Jack Latona's testimony.

STATEMENT OF JOHN LATONA, VICE PRESIDENT—LAW, HOUDAILLE INDUSTRIES, INC.

Mr. LATONA. Thank you, Senator. I appreciate the opportunity to be here today and certainly appreciate your leadership in this whole area of trade and policy. It is extremely important to our entire society.

My prepared statement tells the Houdaille story in some detail. And if anybody wants even more detail on that, we have literally thousands of pages of Japanese——

Senator HEINZ. Without objection we will not put them into the record; but your full testimony will be.

[The complete statement follows:]

STATEMENT OF JOHN LATONA
VICE PRESIDENT-LAW, HOUDAILLE INDUSTRIES, INC.
BEFORE THE INTERNATIONAL FINANCE AND MONETARY POLICY SUBCOMMITTEE OF THE SENATE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE
SENATOR H. JOHN HEINZ, CHAIRMAN
PHILADELPHIA, JULY 7, 1983

Mr. Chairman, in May 1982, Houdaille Industries, Inc., a diversified manufacturer of industrial products including machine tools, filed a petition with the office of the U.S. Trade Representative asking that the President deny the Investment Tax Credit to purchasers of certain Japanese machine tools. The petition was submitted pursuant to Section 103 of the Revenue Act of 1971.

In April of 1983, President Reagan denied our request for relief under Section 103. Administration officials had told us many months earlier that no action would be taken under Section 103 but that if corrective action were to be taken, it would be on the authority of Section 301 of the Trade Act of 1974, as amended. Section 301 requires essentially the same showing of unfair trade practices as 103, but provides a much wider range of remedies, including tariffs and quotas. Thus, the President's denial of our petition under Section 103 still leaves a possibility for action under Section 301 in the future.

In the meanwhile Ambassador Brock's staff and other trade officials have begun discussions with Japanese officials to learn more about Japanese industrial policies, also known as targeting policies. The Japanese have promised to "speak truthfully" about these matters, but, based on our experience in this case, we remain skeptical about just how candid the Japanese Government officials will be. We learned the hard way that precisely the right question has to be asked of precisely the right Japanese official to obtain correct pertinent information. At this point, Houdaille is awaiting the outcome of these talks and considering its options. We have not given up our fight for equitable trade relations with Japan.

Let me now put our efforts into chronological order, concluding with a description of how, in spite of the case we made, in the end the President succumbed to pressure from Japan.

Anyone wishing the full details of our description of unfair Japanese trade and industry targeting practices in the machine tool industry should read the comprehensively documented petition we submitted to the President through the U.S. Trade Representative on May 3, 1982, and later submissions we made to the Trade Representative's office. In addition to the legal analysis of our position, they contain hundreds of pages of official Japanese government documents, both in Japanese and in English translation, describing the official creation of a Japanese machine tool cartel and the wide variety of financial assistance given the cartel by the Japanese government. No one has challenged the veracity of those documents.

In addition, Mr. Copaken of our law firm, Covington & Burling, has made an extraordinarily revealing set of video tapes of his meetings with Japanese officials at technical research facilities funded and, in one case, operated by Japan's Ministry of International Trade and Industry. These tapes prove that our petition is not based on some legal abstraction. They depict in concrete terms what Japanese industry targeting means today.

My statement this morning will merely highlight our findings and describe some of our experiences as we have struggled to bring an element of equity to the fundamentally unfair battle between individual U.S. machine tool producers and the government-backed machine tool cartel of Japan.

Article after article and expert after expert is telling manufacturers that we ought to be ashamed of ourselves for letting the Japanese beat us with their superior quality, better economics, improved technology, etc., all of which have occurred by virtue of their dedication to achievement, their system of lifetime employment, etc. To all of that, we say "phooey."

In industry after industry and particularly in that segment of the machine tool industry we are most interested in, we have found that Japanese achievements have resulted in large measure from very well organized, very well implemented plans initiated by their government to target penetration by its industry of world markets -- especially the United States market because it is the world's largest.

We are a major manufacturer of technologically advanced computer controlled (NC) machining centers and punching machines. We have watched Japanese penetration in those two product lines soar miraculously from around the 4% range as recently as 1976 to approximately 60% and 46%, respectively, in the most recent period. We set out to determine how this was accomplished, for, if the trend continued unabated, the United States machine tool industry would fall mortally wounded before any action under the traditionally available trade laws could be taken.

Approximately eighteen months ago we were becoming increasingly aware of the dramatic inroads being made by Japanese machine tool manufacturers in the U.S. marketplace. Conditions have since become far worse, intensified by the economic downturn, and felt most severely by capital goods manufacturers.

Phillip A. O'Reilly, President and Chief Executive Officer of Houdaille Industries, Inc., has long believed that the Investment Credit should be limited to U.S. value added. In discussing the possibility of legislation to accomplish this, Section 103 of the Revenue Act of 1971 was brought to our attention by Jim Mack of the National Machine Tool Builders' Association. Section 103 gives the President discretion to deny the Investment Credit to foreign goods where the foreign country has engaged in policies unfairly burdening U.S. commerce.

But why turn to Section 103, unused and unheralded, when other remedies ostensibly were available? Section 103 provides a very effective remedy with maximum administrative flexibility. Proceedings under Section 201 of the Trade Act of 1974 invariably take a very long time and many of those who proved their case under 201 still failed to obtain relief. Section 301 of the Trade Act of 1974 had been invoked a comparatively few times and, although some informal government-to-government settlements were achieved, no one had been granted relief under it. There is no need to go on. Anyone familiar with the field knows that in the past the deck has been stacked against U.S. businesses seeking equitable relief from unfair foreign governmental policies and practices. The road is long and arduous, the cost prohibitive and the outcome certain only in the sense that defeat is the greatest likelihood.

We therefore decided that invoking an unused statute might enable us to move more quickly, and achieve favorable results. We also felt that the unique nature of the remedy, and the breadth of the President's discretionary authority that, incidentally, had never been delegated to any agency and therefore was devoid of any red tape, surely made swift use of this statute possible and, we hoped, more likely.

Mr. Copaken determined that our case had to be firmly based on facts rather than conjecture or strong feelings. He and Mr. O'Reilly actually went to Japan and interviewed Japanese officials. The Japanese are forthcoming only if asked precisely the right question and only if precisely the right Japanese is asked. O'Reilly and Copaken scored some direct hits. Also essential to our findings were the efforts of a leading Japanese law firm we retained to analyze and translate Japanese laws and government orders for Mr. Copaken. The results of all these efforts are now on file with the Trade Representative's office: Chapter and verse on the creation and maintenance of the machine tool cartel by MITI and the subsidization of that cartel by a bewildering variety of loans, grants, tax concessions and the now-famous bicycle and motorcycle race betting funds.

The Japanese machine-tool cartel was formed in response to the first of a series of three special laws for the promotion of the machinery industry. In enacting these laws the government of Japan launched an ambitious crusade to seize the higher value-added and most technologically advanced market segment of this fundamental industry. Although these laws were officially characterized as temporary measures, they have remained in effect since 1956 -- one "temporary" measure following on the heels of another.

The Japanese Ministry of International Trade and Industry ("MITI") used the free hand given to it by these laws to weed out manufacturers with small market shares. Each firm whose production constituted less than 5 percent of the Japanese market in a specific machine tool and less than 20 percent of the company's total enterprise was directed to stop manufacturing those tools. The market shares thereby relinquished were turned over to a limited number of larger, more successful producers. Under MITI's guidance these companies then exploited the consequent economies of scale and specialization to penetrate export markets, secure in the knowledge that these advantages would be protected against competitive erosion in the Japanese market.

In taking these actions the government of Japan catapulted its cartel into the high-technology end of the market. MITI successfully pressed the Japanese machine tool manufacturers to act jointly to concentrate their efforts in developing and producing NC machine tools. Each company in the cartel was directed by MITI to increase to 50 percent the NC share of its total production of machine tools. In addition, the cartel was directed to expand its collaborative efforts to include suppliers, customers, service, and other activities.

With the long-range goal of selectively penetrating and dominating important export markets as its guiding principle, the government of Japan devised imaginative strategies for financing this cartel with tax advantages, concessionary loans, research grants, and other direct and indirect subsidies.

In the most unusual example, nearly a billion dollars a year worth of yen generated by wagering on bicycle and motorcycle races in Japan were and continue to be made available by MITI for promoting the Japanese machinery industry, including the machine tool cartel, and the export of these products.

MITI officials confirmed the government's use of this mechanism to support Japan's machinery industry including, specifically, the machine tool segment, but downplayed its importance by quantifying the bicycle racing proceeds subsidy at less than one-half million dollars a year. In preparing our Petition we relied on those assurances, although MITI would not provide documentation in spite of our repeatedly submitted written questions.

Their assurances turned out to be false. We now have official Japanese government and private documents which reveal that in the 1979 Japanese fiscal year, some 919 million dollars were made available from wagers on bicycle and motorcycle races alone to promote the Japanese machinery industry and in Japanese fiscal year 1980, 823 million dollars. This assumes a conversion rate of 201.3975 yen to the dollar in 1979 and 229.66 yen to the dollar in 1980. In yen, the 1980 figure was actually 4 billion yen higher than in 1979. Those who manufacture other machinery products would do well to investigate how their Japanese competitors are benefitting from this annual largess.

The results of this targeting of the U.S. machine tool marketplace were dramatic. The Japanese now make over 50% of the sales in the high technology sectors of the business. Because of the government assistance they receive, members of the cartel offer

U.S. buyers good products at competitive prices with quick delivery and quick service. We have demonstrated that these positive attributes are the result of massive government assistance, not superior engineering or management. Nevertheless, there are those in our country who do not look behind the Japanese products to see the role of government subsidy.

The facts are these: Japanese machine tools are not technologically superior to those made in the U.S. In fact, virtually all Japanese machine tools are directly copied from U.S. designs obtained through licensing agreements or reverse engineering. At the direction of their government, Japanese manufacturers set out to obtain the best designs in the world. They found them in the U.S.

Their ability to deliver stems from their large inventories of machines. U.S. manufacturers generally build to order and thus have longer lead times. It does not require a marketing genius to realize that having machines in inventory gives a seller a decided advantage with buyers. However, U.S. machine tool makers were simply unable to finance the huge costs of such inventories while the Japanese were because of government subsidies.

The same holds true for service. With government help it is possible to maintain larger staffs of service people than those employed by individual private companies. The bottom line is this: The competitive advantage developed by the Japanese following 1976 to the present was not the result of superior skill and effort, but the result of a cartel with a deep pocket, in this case, the pocket of the government of Japan.

We do not view our petition as having been protectionist in any sense. We believe in free trade. We are confident that in a fair fight we can compete with any private manufacturing concern. Competing with a government the size of Japan's is another matter. As long as it provides the extraordinary range of subsidies and direction as we have revealed, we see no free trade theory which justifies the U.S. allowing its manufacturers to lose business and its workers to lose jobs. The Houdaille Petition gave the President a rare opportunity to take an affirmative action for free trade by forcing the Japanese to moderate their practices to a more acceptable level of free and fair competition.

The detailed documentation of Japan's industrial policy that we have provided transformed our case from one of parochial concern into a major opportunity for enhancing the leverage of the United States to open Japanese markets and assure that United States industry and jobs are not lost to unfair cartel competition.

Despite years of talk, the government of Japan continues to resist opening its markets in any significant way to free competition. Until the United States shifts from talk to action, it will always be so. We consider it to be tragic that such an opportunity for making free trade work has been missed.

The Houdaille Petition was the subject of much extremely heated discussion at all levels of the trade bureaucracy. Agencies involved included the U.S. Trade Representative, the departments of Commerce, Treasury and State, plus the National Security Council, the Office of Management and Budget and the Council of Economic Advisors. The departments of Defense, Labor, Transportation and Agriculture also had some input.

The issues were: are Houdaille's facts correct and, if so, what action, if any, should be taken? As the dispute wore on, Houdaille provided voluminous additional amounts of evidence. Further requests for data were made of us which were clearly unreasonable such as: what are the actual costs of making machine tools in Japan and in the United States? In addition to the massive amount of work such research would entail, it also posed obvious legal problems. We could not ask our competitors for their costs without violating the antitrust laws, yet some government officials wanted us to provide that information. After a while it became clear that these requests for additional information were adversarial in nature, designed to harass us, and not for the purpose of gaining more information.

Eventually the conflicting parties within the Administration came to a grudging unanimous agreement: the facts as alleged by Houdaille were correct and they were legally sufficient to warrant taking action under Section 301. Even with this agreement on the facts, and the law, there were those in the Administration who did not want to act. Some were opposed on ideological grounds. They felt that no action by a trading partner, no matter how unfair, could justify erection of any retaliatory trade barrier by the U.S. Others did not want to offend the Japanese, who are extremely sensitive to charges of unfairness leveled at their trade and industrial policies. Some in the Administration supported us strongly, notably Ambassador Brock and Commerce Secretary Baldridge.

In late April, it was decided finally to put the decision to the President. Given the agreement on the facts and their legal implications, officials who favored taking a stand with Japan that would enable the United States to negotiate from a position of strength were optimistic. However, an extraordinary, last-minute intervention by the Japanese government, including a personal note from Prime Minister Nakasone to President Reagan, turned the tide. Sensitive to Japanese feelings and concerned about Nakasone's chances in upcoming political tests in Japan, the President denied Houdaille's request for relief under Section 103, refrained from taking action under Section 301, and accepted in exchange only assurances from the Japanese that they would "speak truthfully" about their trade practices and industrial targeting policies.

Houdaille is not giving up. But America must wake up. We cannot have our critical industries picked off one by one in the name of free trade. American businesses and American workers cannot be burdened with a double standard which allows other nations to practice all of the elements of targeting while we remain "free." Free trade in free markets is the best economic system, but it is not now taking place. Our competitors are allowed the best of both worlds, support and protection from their government and our free markets. Unless we insist on world-wide free trade and enforce it with sanctions on those seeking to take advantage of our economy, a bleak future is before all of us. The United States must see to it that all trade takes place under the same set of rules.

Mr. **Latona**. Right.

Your summary of what transpired is quite correct. Just to touch on it very briefly, we have an even sorrier tale to tell than Chick here.

The Japanese had 4 percent of the machining center market in 1976. They went to 60 percent of that market by the end of 1982. We presented those facts. We presented an extraordinary documentation of Japanese practices of creating a cartel and the machine tool industry, subsidizing it through an incredible variety of techniques.

The administration acknowledged essentially our entire presentation, but then under pressure from the Japanese Government they decided that they would not grant us any relief.

STRUGGLE FOR TRADE EQUITY

We are still engaged in the struggle for trade equity. We feel it is essential that trade between the nations be conducted on an equitable basis as Chick pointed out it in fact is not. We are supporting the Machine Tool Builders' Association petition to get trade relief under section 232 of the National Security Petition.

The basic goal has to be to get everyone playing under the same set of rules. And that's our goal.

I would like to touch very briefly on how our experience and what we have learned relates to your topic today.

The question the Japanese have been extremely successful, whether you call it targeting or industrial policy or what-have-you—we have had some experience also particularly in France with attempts to do the same thing in the machine tool industry. They have been nowhere near as successful, and I think there may well be something unique about the Japanese culture which makes it possible for them to do what they have been doing.

And I would like to point out to the folks from the GAO they are still doing it. It is a big mistake in studying Japan at any level, whether it be economics or anything else, to merely look at the official pronouncements and the laws.

We have, again, written examples where Government programs have been dropped and yet the instruction goes out. Now, you know, we have announced the cancellation of this program. But understand you are still expected to act as if it were in place. And then they have disbanded that; and they say, however, understand you are still expected to provide the information that was previously called for even though we no longer have any of this stuff on the books.

The subsidies in the same fashion. Years ago they started out with the sugar quotas where they gave the right to import sugar to various people they were interested in subsidizing including the shipbuilding industry and the machine tool industry.

That created an uproar. They went from that to giving money from bicycle race betting. Now, there's an uproar about that and so undoubtedly they will switch to something else.

But you cannot look just at the formal structures we heard earlier about.

Senator **Heinz**. I would like to talk about the differences. The GAO, you are quite right, suggested pretty strongly that Japan up until they became a member of the International Monetary Fund had done a lot of targeting and been very explicit but that since then they have been good guys.

Is it your view that the GAO has been taken in by Japanese official pronouncements? Are they naive pointly-headed academics?

Mr. LATONA. I'm not going to use these words.

Senator HEINZ. Or have the Japanese fooled them as they fool everybody else?

Mr. LATONA. I think that anyone who looks at the evidence that we have brought to bear, extraordinary measures of law that were passed, the third of three that started back in 1951 I believe the first one was passed, extraordinary measures of law with regard to the machine tool industry, the elevation plans are still on the books. The last one was passed in 1978. It is still on the books, the elevation plans which call for MITI to provide funds for the implementation of the furtherance of exports by the machine tool industry still in place.

We can show you dollar for dollar, yen for yen, where the bicycle money goes in support of the machinery industry, a portion of which is the machinery tool industry.

Senator HEINZ. Let me interrupt to say that I——

Mr. LATONA. That is all still there.

Senator HEINZ. I'm going to send this part of our testimony plus your entire presentation on Houdaille to the GAO, because they apparently either don't know about it or, if they do know about it, they chose to ignore it. And I'm going to send it to them with a request that they not only review it but they comment on it and tell me whether they will revise their testimony in light of it; if so, how. If not, why not.

Mr. LATONA. Well, the entire package is on file with both the International Trade Commission and the U.S. Trade Rep's office. Literally it is both in translation and in the original Japanese, pounds and inches of documents showing the programs that are still in place, not to mention all the stuff that went before, some of which has been dropped.

But frequently something is dropped and something else is added in its place. There was comment about U.S. Government support of industry research. There's a big difference between the defense-related and space-related research programs in the U.S. Government, not a penny of which has gone to any machine tool company I'm aware of.

JAPANESE BENEFIT FROM U.S. DEFENSE PROGRAMS

The Japanese programs are all specifically aimed at commercial application of product and sale of product. The U.S. programs are designed for defense. They are designed for space.

The spillover effect that Chick referred to has been available to the Japanese. Indeed, their research is based on our research. So they have benefited from that in the same fashion that American industry has benefited from that research.

They have also benefited from those defense programs. We are providing their defense. And to find these defense programs thrown back at us as some reproach to us, Oh, buddy, you are getting something that the Japanese are—it is really the same thing; there really isn't any difference really irritates me a great deal, because they are the beneficiaries exactly as we are plus everything else that their government does for them. That is not anything special for the U.S. industry.

On the other hand, the U.S. Government gets in the way of exports, the whole export control issue. One particular example that we have run across with regard to the antitrust, when we discovered the existence of this Japanese machine tool cartel which was formed with the assistance of MITI, we took the documents to the Japanese Fair Trade Commission and said, look at this stuff. Is this a violation of Japanese law?

Well, I guess it is.

What are you going to do about it?

Nothing.

On the other hand, and, at virtually that same point in time in 1981, an official of the U.S. Justice Department Antitrust Division made a speech on official Justice Department stationery warning American industry that anyone who sought to receive relief from their trade problems, under the trade laws of the United States, was putting themselves in jeopardy of an investigation from the Antitrust Department of the U.S. Justice Department.

The contrast between our Government and the Japanese Government could hardly be greater. And there's just a whole list of other examples of that kind of thing.

Is the Japanese approach applicable to the United States? I really doubt it. The Japanese are successful because they are so tightly knit. It is an entirely different social organization than we have, or than we are ever going to have.

Do we need some kind of super industrial coordinating what-have-you? I am inclined not to think so. I think it would be just one more layer. I think the existing institutions—I'm not saying there should not be some refinement such as you have suggested in S. 849, such as Senator Roth has suggested in the Department of Trade without getting into the specifics of either of those proposals.

But those refinements can take place through the existing institutions of the Congress and the executive branch. We need to do something about antitrust. We need to do something about the tax laws which, as everyone has pointed out, have eschewed for so many years toward consumption rather than toward investment. We need to do something about the incredible obstacles placed by our Government toward international trade ranging from the taxation of overseas workers right on down the line.

All these things can be changed within the context of our existing arrangements and, were they done that way, I think we would see a dramatic change in the position of U.S. industry in the world trade market. We still have the skills. We still have the workers. We still have the capital. And we have no hesitation saying that we feel we can compete both as a company, as an industry with anybody in the world given the same set of rules to play by. And we feel that if our Government can move in that direction, the outcomes will be quite satisfactory to all.

Senator **Heinz**. Jack, thank you very much for those observations. I think the most dramatic of which is kind of like Japanese baseball bats. They claim that they don't have anything. But, as you will, with the baseball bat hitting the head of the mule they sure know how to get your attention. And in my judgment, notwithstanding the GAO's to my mind rather surprising testimony, they do have a policy.

It is difficult for us to evaluate today how successful it is across the board. There is no doubt in my mind it is successful in specific sectors. The Japanese have a culture that permits them when something is not successful to act rather quickly on it. So they know how to cut their losses.

Mr. LATONA. Yes. They do not aim to achieve through this process the political goals. One of the examples—and Chick is going to respond to this, I'm sure, rather differently. I have heard Japanese testify, and I'm basing it solely on it. I'm not knowledgeable in the textile industry.

JAPANESE FORCED OUT OF TEXTILE INDUSTRY

They cite as one of the examples of how the United States has responded as opposed to how they have responded was very early on there were textile agreements, I understand, with Japan which they view anyway as having forced Japan out of the textile business in order to preserve the textile industry in the United States.

They say that that's the best thing that we could have done for them because it forced them out of a low-tech, low-margin industry and left that with the United States and others obviously who picked it up and got them to focus on emerging industry, emerging technology.

Unfortunately, I think one of the things depicted was the machine tool industry. It may be all your fault. I don't know.

Mr. CHAIKIN. Senator, are you familiar with the familiar film Rashaman?

Senator HEINZ. Yes.

Mr. CHAIKIN. May I suggest the following. I have been to Japan three, four, five times; and every time I go, I visit Japanese industries, speak to members of the Ministry, MITI, speak to members of the Department of Labor, the Ministry of Labor, speak to Japanese trade unionists; and the head of the textile, apparel, and clothing, and chemical union is a warm friend of mine.

And simply stated, the reason that the Japanese went out of the apparel industry is that they recognized very early on they could not compete with Taiwan, with Hong Kong, with South Korea, with Thailand, with the Southeast Asian countries.

Their community, their standard of living, their approach toward free trade unions and the other parts of the infrastructure of a reasonably civilized society would not permit them to compete with the oppression in South Korea, with Hong Kong.

And what they did simply was to restructure their industry. They moved their apparel industry to these other communities. Japanese managers are bound in these other communities. Japanese capital set up a lot of these other companies——

Senator HEINZ. Still are.

Mr. CHAIKIN [continuing]. In these other communities. They are very homogeneous. The people who were released in textile, apparel, and clothing are not necessarily of the same type in terms of proportionate achievements and scholarship, in language. They are an extraordinarily homogeneous society almost immediately with whatever retrending is necessary. Technically you could go from the apparel industry to the machine tool industry to the electronics industry to the targeted export industries which were burgeoning.

And they say it simply and completing. There is more added value in these other industries which were sunrise industries in Japan than the difficulty in competing in apparel and clothing with 16-cents-anhour labor in Red China.

Senator HEINZ. Key question then: What do they have, Chick, in the way of a manpower policy or an education policy, if you will, human development policy, that makes them unique? Is it simply culture, or are there policies—I'm advised that under the Japanese educational system the students are in school 1½ months, 2 months longer almost year round; and, second, they work about 3 or 4 hours a day longer.

If you multiply that out, that means their school year in terms of hours is about twice what ours is.

JAPAN IS THE MOST LITERATE NATION ON EARTH

Mr. CHAIKIN. May I make the following general comments? I think they are subject to verification. I think they are the most literate nation on Earth. They have the highest life expectancy. They also are down to population zero. Because they are down to population zero and fewer newer workers are entering their work force, they have a policy of using that labor in the most effective manner; and they do it through administrative guidance and they do it through channeling and funneling these new workers into areas where there is job opportunity and where there seems to be a future for their productivity.

They graduate the highest number proportionately of college and university graduates of any of the Western industrialized nations. One of their biggest exports—and, Senator, if you travel around the world and have the time to go into it, I was amazed at the number of young Japanese that very recently came from Japan, graduates of the university, to take up management positions. They joined me in some of the fine eating places in New York City, and you will find young bright-eyed eager-eyed, intense——

Senator HEINZ. There is no question about it, and they work extraordinarily hard. You can also go about 7 o'clock at night to a health club in New York and you will find that there are more Japanese than there are Caucasians. They have been at it since 5 a.m., and some of them are falling asleep; but they are in there sweating away.

Let me ask you this, though: Why is it that the Japanese don't seem to have the entry level job issue that we have? We have people who either do not have the endownment or do not have the training or do not have the literacy to be as interchangeable as the Japanese. Are they just lucky or is there a facet of government policy?

NO IMMIGRATION INTO JAPAN

Mr. CHAIKIN. One facet? No. There is no immigration into Japan. I had the opportunity to speak to the Prime Minister at or around the time that the problem of the boat people was at its raging height where the people tried to get away from Vietnam; they were drowning; they were just risking their lives trying to get away. And there was a terrible refugee problem. And I have chatted with him and I pleaded with him that as a matter of government policy for the Japanese to accept *x* number of refugees.

You will recall, Senator Heinz, because you were a part of the government infrastructure that in the United States of America we took in hundreds of thousands of these people. You will recall the refugee camps in Malasia. Never mind the subsequent refugee camps along Thailand's border from Cambodia, et cetera. These were the original boat people.

I pleaded with him to take in a reasonable number. The answer was relatively negative. You know, he was too much of a gentleman to say, "The hell you say" or "No way;" very pleasant, very kind; ended up contributing $70,000 to the refugee fund—and if you talk to Victor Palmiari, he will tell you that is the case—and took in none.

While I was there in 1979, the papers were full of stories that for the first time they were going to permit some Koreans who had been in their countries upward of 30 years, some Koreans, to become citizens. It was almost a homogeneous country. They don't have the Third World element coming in. They don't accept people from China, for example.

Senator HEINZ. I think that is a well-made point.

Mr. CHAIKIN. That's No. 1.

Senator HEINZ. Are there any other factors that you know of?

Mr. CHAIKIN. And, second, their educational system, you know, trains people, trains the mind, challenges young minds. And the language is a fairly common language, so there is no—you can almost move people from one area to another, and they understand each other. They don't even suffer from the kind of dialects that they have in the People's Republic of China. And I think all that mitigates transferability.

Senator HEINZ. You do speak differently than Jimmy Carter.

Mr. CHAIKIN. Well, but it may have been one of my great failings if I understood him completely.

Mr. LATONA. In addition to these points—and they are all correct——

Senator HEINZ. They are good points.

Mr. LATONA [continuing]. Social homogeny, the education, the quality of high school education, is so much greater than it is in this country. And all of these things enable the social pressures to be brought to bear to get people to respond in the fashion that they are expected to respond.

As somebody pointed out to me, Japanese workers aren't any happier than the workers in the United States contrary to belief, and it's been noted; but they're not led to believe they should be happier, and that's part of the difference.

They have work rules—or they don't have work rules, to be more precise, as we have in U.S. industry; and not just as a result of labor union things. Our own practice has been to make people specialists and to hone them in those specialties.

The Japanese practice is to make you a fungible entity, and so you are moved from job to job within a particular company. So that if the time comes and that company is out of business, you can move on to another industry with much, much greater ease, because you have had a variety of work experience. You have not just been a diesinker of such and such a dimension, such and such a material, and you are not using that material anymore; good-bye. They have much more flexibility, and that is built into their system.

Senator **Heinz**. That suggests a real challenge for our educational system as well as many attitudinal differences between us.

Mr. **Chaikin**. May I suggest just one item? I know the hour is getting late.

Senator **Heinz**. The hour is getting late for all of us.

Mr. **Chaikin**. The conduct of their labor relations is quite unlike ours. For good or ill, it is less confrontational. It is less adversarial. It is not true that every Japanese worker is guaranteed lifetime security on his job. It never was true. They are some of the things you read about in these magazines. I don't know what the number is, but I doubt that 60 percent of the Japanese work force is ever employed by industries which considered it a moral obligation to keep them employed.

There are startling examples of steel workers in Japan when the steel industry was on the downgrade of these workers cutting grass and doing all kinds of chores around and being kept on the payroll. It is true. But enough of the Japanese understood that when they entered the Japanese work force as a young person—that might be 16, 17, 18, and out of high school—that they started at a level which is about one-third the level in terms of wages to which they would arrive at or around the time of their retirement. And they increased their wages by chronological age.

RETIREMENT AT AGE 55

And that poses a problem for the Japanese, because with fewer newer entrants into the industry and with a push toward keeping them longer—they used to retire their people at the age of 55. The Japanese unions were happy with that.

The Japanese unions in the last 6 or 7 years since the oil strikes of 1973 and the recession of 1974, 1975 have been advocating later retirement, and they have been insisting that workers not be pushed out at age 55 but be given an opportunity to continue to work until 60 and 65 because they have a lousy social security system.

Mr. **Latona**. What happens to you——

Senator **Heinz**. Their employment policy is even more profound than that. They retire them not on a pension at age 55; they retire them on a stipend that is so low that they must stay in the work force doing something which has, among other things, an effect on the younger workers because they are replaceable at any point in time by older workers not in the labor force.

Mr. **Latona**. Typically where they go——

Senator **Heinz**. I'll tell you. We all have planes to catch. I have one that isn't going to stop leaving, unfortunately. I have another hearing that I have got to hold over in Altoona today, so I'm going to have to adjourn the hearing. But I do want to say a special thanks to you, Chick Chaikin, and to you, Jack Latona, for your excellent testimony.

I think you have enriched the record substantially, and it's helped me immensely to take advantage of both of your great expertise to understand many of the rather immense differences between this country and others and many of the substantial challenges we have ahead of us. I thank you both.

Mr. CHAIKIN. I want to thank you for the opportunity to come here.

Senator HEINZ. The hearing is adjourned.

[Whereupon the hearing adjourned at 12:50 p.m.]

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